स्वाध्याय स्वमन्थन स्वावलम्बन

UTTAR PRADESH RAJARSHI TANDON OPEN UNIVERSITY

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MBA-3.2

~~MBA-4.2~~
Management of New and Small Enterprises

FIRST BLOCK
Entrepreneur and Entrepreneurship

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Management of New and Small Enterprises

Block

1

ENTREPRENEUR AND ENTREPRENEURSHIP

BLOCK 1 ENTREPRENEUR AND ENTREPRENEURSHIP

Small Scale Enterprises offer a blend of employment and income generation potential, which coupled with the labour, intensive nature of technologies used and the low cost/job, presents a very desirably direction of industrial growth. Entrepreneurship is a significant factor in development of such sector as is the infrastructural set up needed to facilitate entrepreneurial ventures.

Forming the introductory block of this course, this block consists of three units, the first of which describes the concept of small scale enterprises and discusses the role of this sector in the economic development of the country. The second unit introduces the subject of entrepreneurial competencies and provides a framework for their development. The last unit discusses the policy and institutional interface for small scale enterprises.

UNIT 1 ENTREPRENEURSHIP AND SMALL SCALE ENTERPRISES— ROLE IN ECONOMIC DEVELOPMENT

Objectives

After going through this unit you should be able to :

- Explain the role and need for small scale enterprises in the Indian economy
- Define a small scale enterprise
- Describe the characteristics of a small enterprise
- Discuss the role of small scale enterprises in the economic development
- Discuss the role of entrepreneurship in the economic development
- Identify problems and support needs of small scale enterprises

Structure

1.1 INTRODUCTION

Because of their unique economic and organisational characteristics, small scale enterprises (SSEs) play important economic, social and political roles in employment creation, resource utilisation and income generation and in helping to promote change in a gradual and peaceful manner. Socio-economic factors affecting SSEs came to be noticed during industrial revolution, with notions of entrepreneurial importance gaining favour by the mid-twentieth century.[1] During the 1960s, the behaviour of the individual came to be highlighted as a major factor contributing to SSE development as entrepreneurship and therefore supply of entrepreneurs came to be recognised as critical to development.[2]

However, it has been primarily during the past two decades that attempts to design programmes to promote SSEs as part of national development plans have been implemented. India has been the first among few developing countries to have assigned a significant and categorically stated role to small scale industries from the First Five Year Plan itself.

In India, as in most developing countries, only a fraction of the new job seekers can be employed in agriculture. The scarcity of capital severely limits the number of new non-farm jobs that can be created, because investment costs per job are high in modern industry. An effective development policy has to attempt to increase the use of labour relative to capital, to the extent that it is economically efficient. And efficient substitution of labour for capital

1. J.A. Schumpeter : *The theory of economic development* (Cambridge, Massachusetts, Harvard University Press, 1949).
2. D.C. McClelland : *The achieving society* (Princeton, New Jersey, D. van Nostrand Co., 1961).

is possible in a broad spectrum of manufacturing activities. The tendency in many developing countries, unfortunately, has often been to prefer capital-intensive methods for several reasons : the prestige and promotion of advanced country technologies, ignorance of alternatives, preference by the rich for imported or import-equivalent goods, difficulties of dealing with large numbers of inexperienced workers and government policies that tend to favour the use of capital. These influences also affect non-manufacturing activities.

Small scale enterprises (SSEs) are generally more labour-intensive than larger organizations. SSEs include small but relatively modern manufacturing industry; organized non-manufacturing activity, such as construction, transportation and trading; and traditional or "informal" activity. In India, it must be emphasised, focus has been mainly on small scale industries (SSIs) and therefore policies and programmes to promote 'small' refer to 'industry' rather than the broader spectrum of "enterprises".

1.2 WHAT IS 'SMALL SCALE'—DEFINITION

But "what is small about small scale" and "how small is small" are two questions which immediately arise. Indeed, SSEs comprise a wide variety of undertakings. They can be categorized in diverse ways depending on a country's pattern and stage of development, policy aims and administrative set up. One study found at least 50 different definitions used in 75 countries.[3] Definitions may relate to the capital invested (with maxima ranging from about \$ 25,000 to \$ 2 million) or employment (maxima from 15 to 500) or both, or to other criteria. Some countries have no official definition of SSE; others use two or more for different purposes. No lower limit is set. SSEs thus encompass sole proprietorships, family businesses, small shops with a handful of workers, cottage industries, artisans etc.

A problem does arise when attempting to establish an acceptable upper limit for the definition : **financiers** often talk in terms of upper levels of fixed assets, net worth or value added; **labour officers** may refer to the total number of persons employed; **traders** might use a ceiling limit in sales volume; **service personnel** may use the total number of customers; **manufacturers** may prefer to use maximum levels of energy required for production; or different criteria may be combined in attempting to set the limit at which the enterprise ceases to be "small".

In practice, well over three-fourths of the small enterprises so defined would have fixed assets below \$ 100,000 and employment below 50. In India, small scale industry has been defined by fixing an upper limit of value of Plant and Equipment rather than total fixed assets or employment size. This underscores concern for scarcity of capital relative to labour. Land and building are also excluded, because their value is even more difficult to determine, apart from these being unproductive assets, unlike Plant and Equipments.

However, with rising prices and changing technologies, the upper limit of the size of a small scale unit in India so defined had to be changed over time. From Rs. 5.00 lacs in the fifties, it was raised to Rs. 20.00 lacs in the seventies and very recently, in April 1990, it has been raised to Rs. 60 lacs and for ancillary units Rs. 75 lacs. "Small" has become quite "big" over a period of time.

Activity I

Do you think 'Small Scale' can be defined by using other variables rather than merely the upper limit on value of plant of machinery? Suggest some such variables.

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3. "An International Compilation of Small Scale Industry Definitions" mimeographed (Atlanta, Georgia : Georgia Institute of Technology, Engineering Experimental Station, 1975).

1.3 CHARACTERISTICS AND RELEVANCE OF SMALL SCALE ENTERPRISES

Many characteristics of small enterprises enhance their pivotal positions in accelerating economic growth in countries where they are seriously being developed.

- Their flexibility makes them best suited in environments where intervening variables play a large part in day-to-day business management.
- Also, small enterprises have a better change to carry out a number of innovations like combinations of new products, new materials, new methods of production, new markets, new sources of materials and even new forms of organization.
- Being change-susceptible and highly reactive to socio-economic influences on the outside, small enterprises can easily adapt to and adopt measures that will ensure not only their own viability but also the growth of the economy in which they are situated.
- Being fairly labour-intensive, they provide an economic solution by creating employment and income opportunities in urban and rural areas at relatively low cost of capital investment.
- Decentralization and dispersal of industries into rural areas prevent the influx of job-seekers in cities and urbanizing centres, thus allowing for a more balanced growth of economy in the whole country.
- By using indigenous raw materials and the promotion of intermediate and capital goods, small enterprises can contribute to faster economic growth in a transitional economy.
- Being set up by individuals, they provide a productive outlet for expressing the entrepreneurial spirit of human resources.

The benefits of SSEs can therefore be summarised as follows:

- Utilising local resources
- Creating jobs at relatively low capital cost (lower capital/labour ratio)
- Diversifying industrial structure and foiling monopolies
- Providing a vehicle for introducing a more equitable income distribution
- Attracting and utilising indigenous entrepreneurship
- Developing a pool of skilled and semi-skilled workers as a basis for future industrial expansion
- Improving forward and backward linkages between economically, socially and geographically diverse sectors of the economy
- Providing opportunities for developing and adapting appropriate technological and managerial approaches
- Increasing mobility for the improved development of natural resources
- Adapting flexibility to market changes

1.4 RELATIONSHIP OF SMALL TO LARGE

he Industrial Revolution was accomplished largely through small scale industries (SSIs)-ntities with modest capital, a few score workers at most, owned and managed by a single ıdividual of family. Really large firms were slow to emerge. As late as 1900, the hundred ırgest British industrial firms accounted for no more than 10 per cent to 15 per cent of ıanufacturing value added, and the same held in the rest of Western Europe and North merica. The explosive growth of really large scale organizations occurred in the next half entury; large firms are now the dominant mode. Typically, the hundred largest ıanufacturing enterprises in developed economies to-day control at least half of total ıanufacturing assets, with a varying but comparable figure for value added. But their share f employment is smaller, relative to output.

lonetheless, many small manufacturers continue to exist in these economies, showing a kewed distribution of manufacturing enterprises with the modal size being close to the nallest and a long rightward tail stretching towards the giants. Most of the small firms are ervice oriented, or produce for a circumscribed or specialized niche in the market. Many roduce intermediate products for large firms; the development of the sub-contracting lationship was particularly marked in the economic history of Japan.[4] As industrialization

See Suzanne Paise, "Lessons for LDCs from Japan's Experience with Labour Commitment and Sub-contracting in the Manufacturing Sector," Bulletin of the Oxford Institute of Economics and Statistics 33, No. 2 (May 1971), pp. 115-133, and Table 1 : 1.

proceeds, small firms seem naturally to shift from activities that compete with large firms to complementary ones.

Besides the small firms involved in sub-contracting, why do so many other SSIs continue to exist? A simple answer is that they have distinct advantages in organization and marketing flexibility. A more profound answer lies in the nature of the process by which firms grow. Even if, in the absence of direct or implicit government restriction, the ultimate size of the modern corporation may be unlimited, financial, organizational and marketing constraints affect its rate of growth. On the financial side, past profits limit future growth; as for organization, excessively rapid expansion, rather than excessive size, leads to the characteristic forms of managerial inefficiency.[5] Enterprises often play an important role in developing skills, especially in developing countries, but there is a limit to the number of people who can be effectively trained in any given period.

After World War II the model of industrial development in Eastern European and Western industrialised countries featured large, integrated plants; this is what was available for sale, conceptually and commercially. And it was what the new business leaders in the developing countries, or their government planners and managers wanted. It seemed the modern way to catch up quickly, using imported technology and turnkey contracts. The big enterprises, public or private, enjoyed tax, tariff, import licensing and credit favours, while smaller units survived as best they could, often with serious handicaps in relation to the administrative and financial establishments.[6]

Such exotic industrial implants have a poor record the world over; nationalized industries, many corporate mergers, and state enterprises (e.g. public sector projects in India) provide familiar examples.

Activity 2

Survey 10-12 small scale industries in your vicinity/local area. Classify them according to their area of operation i.e. whether producing intermediate products or service product or speciality products. Discuss with them to find out what are the specific strengths that they have in comparison to a large scale enterprise, which make them more adaptive.

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1.5 EMPLOYMENT CREATION

A more explicit case for encouraging SSIs lies in their employment creation potential. Current interest in SSEs in developing countries stems largely from the widespread concern over unemployment. Large firms designed on western industrial countries' models have undoubtedly raised industrial production and productivity levels in many developing countries, but without reducing unemployment correspondingly, so that rising output is often associated with widening poverty. An alleged capital-intensive bias in large firm

5. See, for example Edith Penrose, *The Theory of the Growth of the Firm* (New York: John Wiley and Sons, 1969), p. 47 ff. Mason Haire, *Modern Organization Theory* (New York: Krieger, 1959), p. 28 3; Peter Marris, *The Economic Theory of Managerial Capitalism* (London: Macmillan & Co. 1964), p. 114 ff.
6. World Bank, "Financing Small Scale Industry," Research Project ref. No. 670-77 (Washington, D.C.: World Bank, 1974).

development is held partly responsible, while small firms are said to be more labour intensive without necessarily being too costly or unprofitable.

Table 1

Fixed Assets per Job in Direct Employment for Selected Developing Countries

Size of enterprise	India (1) (1965/1973)	Colombia (2) (1974)	Mexico (3) (1970)	Phillippines (4) (1970)
	(US $)	(US $)	(US $)	(US $)
Small	278	3,000	3,700	1,020
Medium	557	—	9,500	2,850
Large	2,450 (5,000)	13,400	14,500	8,000

Source : (1) Annual Survey of Industries 1965 (Calcutta) Government of India, Department of Statistics; the $ 5,000 figure is from Financial Performance of Companies 1973/74 (Bombay: Industrial Credit and Investment Corporation of India Limited, 1975) p. 23.

(2) El Mercado de Capitales en Colombia (Bogota: Banco de la Republica, 1974). Other estimates of the cost/job ratios in Colombian medium and large enterprises range as high as $ 15,000 to $ 22,000.

(3) 1970 Industrial Census.

(4) Sharing in Development, ILO.

Lower Investment Cost per Job: Comparative investment costs per direct job generated as seen in Table 1 above suggest that small enterprises use significantly more labour-absorptive inputs. What is important is the relative labour intensity, roughly 4 to 10 times higher for small firms. Smaller firms also generally employ more labour per unit of capital. This conclusion corresponds also to the conclusions of an earlier study on a number of developing countries "that smaller enterprises (excluding the smallest), with a lower level of investment per worker, tend to achieve a higher productivity of capital than do larger, more capital-intensive enterprises."[7]

Poverty Alleviation: To what extent, however, do smaller industrial units contribute more to employment of poor people in urban or rural non-farm settings? Insofar as they create a greater number of job opportunities at the margin, it may be that the urban jobless will benefit. Moreover, according to a World Bank Study, small to medium enterprises sponsor projects with an appreciably higher proportion of unskilled workers than medium to large enterprises—65 per cent as compared with about 50 per cent. Creation of unskilled jobs certainly has a direct impact on the alleviation of poverty which is greater for small and medium enterprises than for larger ones.

Indigenisation: Further evidence to employment effect is linked to the inputs used by small and large firms. The latter usually have a much higher propensity to import raw materials and capital goods. Small firms buy more domestic inputs produced by indigenous labour.

The size of firm, and/or the capital intensity of its operations, often is dictated by its products and technology available for their manufacture. Backyard blast furnaces may not have been efficient in overall use of resources. However, small foundries or metal-working plants may be both relatively labour intensive and competitive.

Use of labour-intensive techniques in large enterprises often pose special difficulties, e.g. labour union pressure or government regulations, which weigh much less heavily on SSIs. It is partly to avoid such problems that the large firms move towards capital intensity and less "appropriate" technologies. So, where an option exists, SSIs may be more inclined and better able than large firms to use resources efficiently.

Avenues for Indigenous Entrepreneurship

SSIs also make better use of indigenous organizational and management capabilities by drawing on a pool of entrepreneurial talent that is limited in the early stages of economic development and by providing opportunities for these entrepreneurs to gain experience. The

7 Keith Marsden, "Towards a Synthesis of Economic Growth and Social Justices", *International Labour Review* 100, No. 5 (November 1969), pp. 389-418.

more successful ones will generally grow larger and doubtless more capital intensive, and in the process will fulfil an important incubating function.

Managerial and entrepreneurial abilities must however be distinguished. The latter is often neglected in development planning and policies, partly because it is hard to define. Yet its importance is evident in performance comparisons among countries and sectors where individual or collective initiative is encouraged, and where bureaucratic constraints discourage it.

SSEs provide productive outlets for the talents and energies of enterprising, independent people, many of whom would not fulfil their potential in large organizations. Small firms often flourish by serving limited or specialized markets that are not attractive to large companies. They provide a seed bed for entrepreneurial talent and a testing place for new industries. They supply dynamism and contribute to competition within the economy.

Tapping of Savings

The potential savings role of SSI development has not been adequately tapped. Quantitative data are scanty, but empirical evidence from many countries over the decades shows entrepreneurs are very highly motivated to save and invest; they reserve a greater proportion of their incomes for this purpose than does the general population. This partly reflects their inability to obtain financing from institutional sources; but it also stems from their psychological commitment to the enterprise, which is both their essential security base and their best hope for an easier, more secured existence. In rural areas, given conditions of confidence, funds may be mobilized from large farmers and channeled into rural industry.

Utilisation of Domestic Technology

SSIs are more likely than larger firms to use relatively simple, general-purpose machinery that is often obsolete by developed country standards. Such machinery can often be manufactured locally; small machine shops, themselves quite labour intensive, exist in almost all countries, even the least developed, and are excellent training grounds for mechanical skills. Their machinists become intimately familiar with the customers' equipment, including SSIs. Perhaps originally imported, often second-hand, this equipment is likely to need frequent repairs or replacement parts which the original supplier probably no longer manufactures. The local industrialist may see ways to modify the original equipment to suit his needs better, and commission the neighbourhood machine shop to work out an improvement. Gradually, machine building and adaptive capability evolves, stimulated and supported in the first instance by the small scale user of simple less efficient or elegant machines. Large showpiece industries, seeking instant modernity, provide little sustenance for the early stages of local machinery working.

Activity 3

With reference to the industries surveyed for activity 1, find out whether the technology used was an imported one or a domestic one. Describe the reasons given for the use of indigenous/imported technology.

1.6 REGIONAL BALANCE AND RURAL DEVELOPMENT

In most developing countries, industry is highly concentrated in a few places. As a result, regional imbalances are aggravated between (1) the urban core and the peripheral areas, with the latter remaining relatively underdeveloped; (2) urban and rural populations, with migration of the more vigourous elements depleting the rural society and increasing urban unemployment; and (3) major regions within the nation, leading to political tensions. Both large and small industries contribute to these imbalances, the latter when stimulated by or dependent on the former. But SSI generally has more locational flexibility; it requires less infrastructure and usually caters to a narrower geographic market. Its relatively labour-intensive technology is appropriate for the lower wage rates prevailing outside the metropolitan centres, while helping in some measure to raise these rates. Comparative studies suggest that the profitability of SSI is higher in medium-size towns, away from the metropolis, so the promotion of SSI development in outlying towns helps individual entrepreneurs as well as the society as a whole.

A major problem in the rural areas of developing countries is under employment, especially in the slack agricultural seasons; rural incomes are depressed and migration to the cities increases. More non-farm jobs need to be created and, whether these are industrial jobs, they will generally be in the small scale sector, because of infrastructure, market radius, and labour skill requirements. Agricultural processing industries create employment and increase returns to farmers. But their peak demand for labour is likely to coincide with the peak agricultural season rather than complement it. Other types of small scale production, such as black-smithing, brick-making, lime kilns, tailoring, carpentary and furniture-making, are indispensable to rural development.

Environmental Impact

SSIs, just as their larger counterparts, can pollute or otherwise affect the environment adversely. However, their smaller size and dispersion, lesser need for massive infrastructure, and generally simpler processes are likely to result in less and more easily remedied environment consequences.

1.7 ROLE OF ENTREPRENEURSHIP IN SSE AND ECONOMIC DEVELOPMENT

:ffectiveness of small enterprises depends upon the entrepreneurial and managerial :apabilities of those involved in the business. Because of its size and unique operating haracteristics, a small enterprise requires a management approach which is also unique. mall enterprises are generally managed in a personalized fashion. The owner is also the nanager until the firm grows to a certain level. They participate in all aspects of managing ne business and there is generally no sharing in the decision-making process. As far as cope and scale of operations is concerned, small enterprises usually serve a local or egional market rather than a national or international market. They also tend to have a very mited share of a given market. These special characteristics must, therefore, be taken into :count in planning for small enterprises development on a national scale.

he entrepreneurial spirit, as described by recent studies and experiences on the subject, volves not only a desire to gain monetary benefits but also an admixture of a high need for :hievement and all the motivations evident in a high achiever. Long-term involvement with goal which the entrepreneur has set for himself creates the need to persist with the ndertaking even in the face of difficulties and hardships.

anagement and entrepreneurial skills must, therefore, be blended in the small enterprise vner's total make-up as these will spell the difference between success and failure. The eal would be to find a man who is both efficient and effective. Without the latter capability nan may simply be a good manager. He still has to be developed into an effective anager by inculcating in him the entrepreneurial spirit.

ide Ranging Contributions

ere is a wide range of significant contributions that entrepreneurs and entrepreneurship n make to the development process. These include the following:

- Entrepreneurship raises productivity through technical and other forms of innovation.
- Entrepreneurship is a powerful tool of job creation.
- Entrepreneurship facilitates the transfer of technology.
- Entrepreneurs play a strategic role in commercializing new inventions and products.
- Entrepreneurs play a critical role in the restructuring and transformation of economy.
- Entrepreneurs help reduce the ossification of established social institutions and the concentration of economic power.

(7) Entrepreneurship and entrepreneurial behaviour can breathe vitality into the life of large corporations and governmental enterprises.

(8) Entrepreneurs make markets more competitive and thereby reduce both static and dynamic market inefficiencies.

(9) Micro-entrepreneurs operating in the informal sector circumvent established government authority when governments and their programmes inhibit economic development.

(10) Entrepreneurs stimulate a redistribution of wealth, income and political power within societies in ways that are economically positive and without being politically disruptive.

(11) Entrepreneurs improve the social welfare of a country by harnessing dormant, previously overlooked talent.

(12) Entrepreneurs create new markets and facilitate expansion into international markets.

Cost-Effective Strategy

The unique feature of entrepreneurship is that it is a low-cost strategy of economic development, job creation and technical innovations. Other agents of change may accomplish the same ends, but not as cost effectively as entrepreneurs. And this is accomplished by setting up enterprises, initially as a small scale. For entrepreneurs are individuals who bear the costs and risks of launching a new venture, developing a new product, commercializing an invention, adapting a technology and developing a new market. Even when they receive governmental assistance through subsidized training or low-interest loans, they add considerably more value through "sweat equity".

As risk bearers, entrepreneurs either succeed and make a developmental contribution or they fail and disappear from the market place. The market within which the entrepreneurs operate has little tolerance for miscalculations about a business opportunity, for a lack of commitment or laziness, or for incompetence. Entrepreneurs find resources and fill market gaps that would be missed by larger, more bureaucratic organizations. Entrepreneurs allow a country to extract every last bit of marginal capacity out of whatever resources exist within society.

Entrepreneurs and their families oppress themselves in a way that people are reluctant to accept from large scale organizations. This benefits society in two ways—first by extracting extra effort from people and second by avoiding disruption and instability of labour conflict.

Finally, local entrepreneurs offer a cost-effective strategy of development because they are an integral part of their community. Unlike foreign firms or plant relocations from another region or province, small scale entrepreneurial firms are home grown, and available evidence shows that they remain in their community. Tax holidays and subsidies to attract plant relocations whether on a domestic or international basis are far more expensive than cultivating local entrepreneurs, and it is dubious whether the results are real or lasting.

Activity 4

Contact two or three small enterprises which are family enterprises. Discuss the adjustments that members have personally made in order to make the enterprise more cost effective. Given a formal organizational set up, do you think people will be willing to make similar adjustments.

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1.8 A CONCEPTUAL MODEL

If we recognize that economic development is an uneven process that has distinct phases over time, four phases of development can be identified:

1) Agrarian or resource society.
2) Early industrialization.
3) Mature industrialization.
4) Service and high-technology economy.

n terms of the relationship between entrepreneurship and economic development, Table 2 uggests two basic trends: first, the sphere of entrepreneurial activity expands with conomic development; and second, innovation and early imitation become increasingly nportant as an economy develops and moves towards the frontiers of science and chnology.

Table 2
Conceptual Model of Entrepreneurship and Economic Development

	Agrarian society	Industrialization early	Industrialization mature	Service economy
vel of entrepreneurial ivity	Low	Medium	Medium	High
all business formation l Management	Low	High	Medium	Low
repreneurship and ovation	Nil	Low	Medium	High

ere is probably a sequence of strategies that developing countries might follow e Table 3). When agriculture or resource extraction dominates, small business formation robably the most appropriate strategy to be pursued. Small business formation at this se of development means putting existing resources together in either new or old ways. a country begins to develop, imitation of innovations established in more developed ntries becomes critical to the development process. Entrepreneurs during this period d to make more ellective use of existing resources through (a) innovations in anization and/or (b) combining factors of production in new ways (the introduction of the ver-loom to replace the hand-loom). As a country becomes more industrial, it is more ortant for entrepreneurs to identify and satisfy new wants. Early stage imitation becomes easingly important if local entrepreneurs are to compete successfully for even domestic kets.

concluded, therefore, that the entrepreneurial process begins in less developed countries the formation of small businesses and striving for effective management, but ssarily shifts to innovative and high technology entrepreneurship at some point along levelopment path.

Table 3
Entrepreneurial Strategy at Different Phases of Development

of development	Entrepreneurial strategy
ian Society	Small business formation
industrialization	Small business formation and late imitation
: industrialization	Increasing emphasis on early imitation
e/high technology	Early imitation and innovation

PROBLEMS AND SUPPORT NEEDS OF SSEs

ssful small enterprises do not emerge, and thereafter survive and grow unless the onment is conducive. Political, economic, technological and socio-cultural factors in vironment impinge upon the life of the small enterprises and generate much of the required for their existence.

Conducive Environment

The overall political climate in a country is important for the small scale entrepreneur to consider: He will need positive and encouraging measures by government and political constituencies to establish private investment. Such measures could include liberal or non-restrictive investment policy, creation of promotional agencies, creation of industrial estates and free trade zones and availability of low-cost loan capital for private investors. Policy commitment to SSE sector can go up to protection against imports, reservation of products as done in India.

The political climate influences the economic direction taken by the country in question. An analysis of the **economic** environment is particularly helpful in investment decisions, market measurement and in forecasting. The general state of the economy dictates what the small enterprise will need especially since it is handicapped in obtaining capital and credit owning to greater unit costs of small transactions, greater risks involved, etc. The small entrepreneur also generally lacks managerial and technical knowhow, or is weak in marketing, production or personnel management skills. These are needed so he can be economically viable even if he operates on a small-scale basis.

Technological advances in the environment create new needs for the small entrepreneur as far as adaptation and adjustment is concerned. He may need to learn how to adjust to the new technological environment surrounding him, or he may need to take a set of advanced technologies and bring these to his own level in the small enterprise. Either way, constant re-examination is needed for possible utilisation and improvement of existing technologies.

Finally, the **socio-cultural environment** also creates a very important climate for the survival of the small enterprises. They need several conditions to keep being alive:

(1) tolerance for changes in the society and culture
(2) social mobility
(3) tolerance of profit-making and
(4) tolerance of private ownership.

It is the entrepreneurs who set up enterprises. There needs as human resources must not be overlooked. Being the kingpin in the whole small enterprise development process, the factors responsible for the emergence and growth of entrepreneurship must be analyzed and supported, for without the person behind it, there can be no small enterprise to think of. India has been a pioneer in initiating Entrepreneurship Development Programmes (EDPs) to identify, select, motivate, train and guide new, first generation entrepreneurs from all walks of life, thereby increasing supply of capable entrepreneurs for SSIs. Entrepreneurship development is now being introduced in schools and colleges to provide self employment orientation to the youth and change the middle-class mentality for "job-seeking".

Adequate Credit Assistance

Small enterprise development cannot be ensured without arrangement for financing. Adequate and timely supply of credit is critical for new entrepreneurs to emerge especially from a wide base. A great majority of small and medium business activities have come about because of special financing programmes offered to them.

Various financing programmes have been evolved in developing countries to meet specific needs of existing and prospective entrepreneurs. These usually take into consideration the difficulties and special needs that the prospective small enterprise borrower encounters. Thus, requirements are less strict in terms of (1) lower interest rates than the prevailing commercial rates, (2) less collateral requirements and lower equity ratio, (3) various assistance schemes such as preparing the project study etc. Special loan guarantee schemes have proved to be useful whereby the government guarantees the loan of a small entrepreneur by banks. Sometimes, the financing needs cannot be met simply through the provision of loans. Hence, other schemes for equity assistance have been evolved.

Markets and Marketing Support

Market for a small enterprise in a developing country can be quite a problem considering that the small entrepreneur will be in competition not only with locally mass-produced goods but even imports. Small enterprises must therefore prove that in quality and price of their product they are comparable, if not better, than that of larger, better-known brands. Small enterprises can brand together and sell their products as one body through closely-knit associations or organizations. The government too can take an active part in marketing specific products or assisting small groups of entrepreneurs in selling their products. It can directly purchase products of SSIs on a preferential basis, even giving better prices as has been done in India. Other indirect marketing assistance programmes include provision of space for retailing of the small entrepreneurs' products, bulk-buying for future selling, improvement of roads, communications and other infrastructure facilities to improve and hasten sales.

Both large and small enterprises stand to gain if complementarity between them is fostered especially in the marketing aspects of their businesses. A large number of small enterprises manufactures goods for direct sale to a large industry. The government can promote such complementarity as a strategy for small enterprise development.

Acquisition, Transfer and Adaptation of Technologies

Problems are faced in acquiring "appropriate" technology that which is best suited to the specific cultural, economic, social and political climate found in a particular country where the small enterprises are situated. E.F. Schumacher coined the term "intermediate technology" to signify "technology of production by the masses, making use of the best of modern knowledge and experience, conducive to decentralization, compatible with the laws of ecology, gentle in its use of scarce resources, and designed to serve the human person instead of making him the servant of machines."

New industrial technologies which would be both modern and appropriate can be developed by (1) starting with traditional and using modern knowledge to improve on them; (2) starting with the modern methods of the highly developed countries and adapting them to the conditions of the newly developing countries; and (3) analyzing the technological problems of the newly developing countries directly and coming up with novel approaches through fresh research and development.

Nations in the developing world are now looking for new forms of industrial equipment and manufacturing processes. The new class of technologies which are emerging from this search have certain characteristics in common: they are small scale, low cost, easily maintained, worker-controlled, and meet the basic needs of the people.

Early efforts along the lines of acquisition, transfer and adaptation of appropriate technology for small enterprises has provided a strong foundation for bringing about self-reliance in capital goods in India. Technical information and industrial extension centres play an important role in the "delivery" of technology to small enterprises.

1.10 ROLE OF GOVERNMENT IN SSE DEVELOPMENT

Direct assistance which government can lend to small enterprises can include advisory services (extension and counselling), industrial research services, developmental financial scheme, marketing aids and provision of basic utilities and services for small scale entrepreneurs. Simplified export procedures for small enterprises can also be very useful as incentives for this sector of the business community. Unit 2 explains the institutional infrastructure for SSI.

On a more indirect and general way, streamlining of the bureaucratic system and lessening of red tapes will create an overall atmosphere wherein professionalism and the spirit of service prevail. Such an atmosphere will, of course, be conducive not only to small enterprise development but to national progress as well. Inasmuch as the role of government in developing countries assumes the major share in development as builder and catalyst, a healthy policy towards small enterprises, their needs and requirements, will ensure life and growth of this sector of the economy.

1.11 SUMMARY

There are several factors that govern the pattern and rate of economic development in a country. One of the important inputs is provided by the quantum and quality of entrepreneurship. Most of these entrepreneurs who owned and managed their enterprise in the early stages of development did so through ploughing back of profits. In the later stages of industrial development, technological changes favoured the growth of corporate enterprises.

In India, only a fraction of the total employment potential can be fulfilled in agriculture and as cost per job are very high for modern industry, development of small scale enterprise represents a cost effective developmental policy. Being more labour intensive and less capital intensive than large enterprises small scale enterprise in the Indian context seem to be an effective way to capitalize a country specific resources. The unit describes the relevance and need for small scale enterprises and discusses their role in the economic development of the country.

1.12 SELF-ASSESSMENT QUESTIONS

1 Which characteristics of small scale enterprises enable them to contribute to the economic development process in a developing country like India? Discuss.

2 Taking specific case examples discuss the employment generation potential of small scale enterprises vis-a-vis the large enterprises.

3 In the Indian context, explain the specific role that entrepreneurship has fulfilled in the development of small scale sector.

4 With reference to the support needs of SSE's outlined in the unit, do you think the Indian infrastructure and environment is conducive to the development of small scale enterprises. Discuss, giving reasons for your answer.

1.13 FURTHER READINGS

J.A. Schumpeter: *The Theory of Economic Development* (Cambridge, Massachusetts, Harvard University Press, 1949)

D.C. McClelland: *The Achieving Society* (Princeton, New Jersey, D. Van Nostrand Co., 1961)

UNIT 2 ENTREPRENEURIAL COMPETENCIES

Objectives

After going through this unit you should be able to :

- explain the concept of entrepreneurial competencies
- enumerate the competencies relevant for entrepreneurial development
- discuss the role of knowledge, skill motives and traits in entrepreneurial competencies.

Structure

2.1 INTRODUCTION

How do you define an entrepreneur? Can you recognise one when you see one? The commonest definition could be 'a person who organises, manages and takes the risk of running a business or enterprise.'

Entrepreneurs can be of different types and may prefer to go it alone or share the risks in groups with others. Some of the entrepreneurial types that you may recognise from among the ones you know may be—

Solo Operators who essentially work alone or have a few employees. Most people, when they think of starting up a business perceive themselves like them.

Active Partners are basically solo operators who have partners to contribute money to the business without actively participating in it.

Partners are those entrepreneurs who carry on the enterprise as a joint activity, all of them actively participating in the business of the firm.

Investors are those whose chief competence is their creativity and inventiveness. They like to invent new products and may need to set up a business to make them commercially and market them. As their interest is basically in research, and as they often lack managerial experience or desire to run a business, they end up disenchanted and frustrated.

Challengers are those who get into business because of the challenge it represents, and tend to get bored when it seems to be settled and doing well. They then begin to look for newer challenges.

Buyers tend to purchase business rather than start one themselves as it appears to them to be the less risky alternative.

Lifetimers are those who see their business as integral to their life. It is a matter of ego satisfaction and personal concern to them to run the business successfully, family enterprises and businesses depending on exercise of personal skill come in this category.

Activity 1

Administer the following questionnaire to ten entrepreneurs and classify them according to the types that you have studied above.

Questions

i) What do you prefer most working solely on your own, partly on your own or mostly with other people?

b) Do you [illegible] new things or new methods or would you rather sell existing products?

c) Would you rather start from scratch or buy a distribution or somebody else's business?

d) Are you looking for a long term business a just a way to get some quick money?

e) Do you want to manage a business on a short term basis and then sell it over to someone?

f) Do you want to get into business for the sheer challenge of it, to prove yourself?

2.2 ENTREPRENEURIAL COMPETENCIES—MEANING

The success of a small scale industrial venture depends on the following major factors:

a) Inherent viability of the project, i.e. technical, organizational, financial and commercial viability.

b) The way a project is planned, i.e. decisions regarding various project parameters such as where to locate, what technology to use, what should be the capacity of the machineries, etc.

c) The meticulousness with which a project is implemented.

d) The way a project is managed.

While one can add certain other factors to this list including the environmental factors, the said factors appear to be major ones. Let us focus our attention on the last 3 factors mentioned above, i.e. project planning, implementation and management.

In a small scale enterprise, it is the promoter of the project, i.e. the entrepreneur who does most of the functions of the project planning, implementation and management. If the size of the project is big enough to call for employing professional managers, it is the entrepreneur who acts as a driving force behind performance of these three aforesaid major tasks. In order to plan a project flawlessly, implement it meticulously and manage it effectively, an entrepreneur needs to possess certain knowledge, skills and appropriate personality profile.

Entrepreneurship Development Institute of India took up a research project to identify what it takes to be a successful entrepreneur. The research project was initiated by Prof. David C. McClelland, a well known behavioural scientist and was taken up in 3 countries—India, Malawi and Equador. The output of the research project has been identification of a set of entrepreneurial competencies or characteristics that lead to superior performance. A major finding of the research project was that the said competencies are cross culturally valid. In other words, in order to perform well as an entrepreneur, it is necessary to possess the competencies in varying measures irrespective of the geographical locations, where the entrepreneur is operating.

In this unit, an attempt has been made to explain the concept of entrepreneurial competencies.

What is a Competence

A competence* is an underlying characteristics of a person, which results is effective and/or superior performance in a job. A job competence is an underlying characteristics of a person, in that it may be motive, traits, skills, aspect of ones self-image or a body of knowledge which one uses. The existence of these characteristics may or may not be known to the person. In this sense, the characteristics may be unconcious aspects of the person. In simple terms, a competence is a combination of body of knowledge, set of skills and cluster of appropriate motives/traits that an individual possesses to perform a given task. In order to understand more about competencies, let us understand the meaning of knowledge, skills, traits and motives, which form various components of entrepreneurial competencies.

What is Body of Knowledge

Knowledge means collections of information and retention of facts that an individual stores in some parts of his brain. Let us take an example of swimming. One could be in a position

* "The Competent Manager" by Richard E. Boyatzis (John Wiley & Sons Inc. UN 1982).

to describe how to swim which would mean that one possesses knowledge of swimming. But this alone will not enable the listener to actually swim unless one has something more than the knowledge component to perform the activity. It means that knowledge is necessary for performing a task but not sufficient. In real life situation, one may find various examples, where people possessing mere knowledge have miserably failed while performing the task. Besides knowledge, an individual should have skills to translate the knowledge into action.

What is a Skill

Skill is the ability to demonstrate a system and sequence of behaviour that are functionally related to attaining a performance goal. Using a skill is not a single action. The relationship among the specific actions is such that each contributes under some direct manner to the capability of people to function effectively or ineffectively in a given situation. Since a skill is the ability to demonstrate a system and sequence of behaviour, it must result in something observable, something that someone in the person's environment can 'see'. For example, planning ability is a skill. People who have this skill can identify sequence of action to be taken to accomplish a specific objective. They can identify potential obstacles to those actions. People with this skill can identify sources of help in avoiding obstacles or overcoming them when they interfere with the action sequence. None of these separate actions, constitutes a skill, but the system of behaviour does. People who have this skill can apply it in any number of situations or contexts.

Going by the example of knowledge of swimming, if one has to be in a position to swim, one needs to have the skill too. Knowledge could be acquired by reading, listening, visuals etc. while skill can be acquired only through practice, which enables the individual to demonstrate the system and sequence of behaviour that are functionally related to performing a task. In other words, knowledge of swimming could be acquired by reading, talking to experts and so on whereas the skill to keep oneself afloat on water can be acquired by practising on a number of occasions. Thus, knowledge as well as skills are required to perform a given task effectively.

Motives and Traits

A motive is a recurrent concern for a goal state or condition appearing in fantacy, which drives, directs and selects behaviour of the individual. Motive includes thoughts related to a particular goalstate. For example people who think about improving their own performance and competing against a standard of excellence are said to have Achievement Motivation. When people with high achievement motivation encounter a situation in which their performance can be measured and a goal can be stated, their achievement motivation is aroused. Once aroused, the motivated thoughts direct and select their behaviour, i.e. they will choose to do things that help them get feedback on their performance and engage in activities that may result in improved performance. In simple terms, motive is an urge for which one has continuous concern in his mind which directs one to get into certain actions so that the concerns that one shows gets satisfied.

Coming back to the example of swimming, the knowledge on how to swim followed by practice which would help an individual to acquire skills in swimming would lead to the individual acquiring capability to swim. But then this does not lead to him becoming the best swimmer within a given reference group. The individual's urge to do better and better leading to a desire to become the best swimmer could be termed as a concern for excellence—in other words achievement motivation. It is this concern which would help the individual to constantly practice swimming, look out for ways and means of increasing the speed thereby ultimately increasing the possibility of becoming the best swimmer.

A trait is a dispositional or characteristic way in which the person responds to an equivalent set of stimuli. A trait includes thoughts and psycho-motor activities related to a general category of events. For example, people who believe themselves to be in control of their future are said to have the trait of efficacy. When people with this trait encounter problem or issue in any aspect of life they take initiative to resolve the problem or understand the issue. They do not wait for someone else to do it nor expect that luck will take care of it. The thought pattern and resultant behaviour occur in response to any general set of events, which allow the trait to be expressed.

Thus to perform any given task including that of launching an industrial venture and managing it successfully, a person needs a set of knowledge, skill, motives and traits which could be together labelled as competencies.

2.3 MAJOR ENTREPRENEURIAL COMPETENCIES— A RESEARCH STUDY

The knowledge of entrepreneurial competencies has been sharpened over the last 3 decades. Earlier, there used to be a firm belief that those persons with business family background could become successful entrepreneurs. Subsequently there was a belief that individuals need technical knowhow, as a major requirement for being successful in launching an industrial venture. In order to understand clearly what it takes to be a successful entrepreneur, EDI took up a research project as indicated in para 2.2 above. Following is a list of major competencies that contribute towards top performance :

i) **Initiative :** An entrepreneur takes action that go beyond job requirements or the demand of the situation.
   - Does things before being asked or forced by the events.
   - Acts to extend the business into new areas, products, or services.

ii) **Sees and Acts on Opportunities :** Looks for and takes action on opportunities.
   - Sees and acts on opportunities (business, educational or personal growth).
   - Seizes unusual opportunities to obtain financing, equipment, land, work space, or assistance.

iii) **Persistence :** Takes repeated action to overcome obstacle that get in the way of reaching goals.
   - Takes repeated or different actions to overcome obstacles.
   - Takes action in the face of a significant obstacle.

iv) **Information Seeking :** Takes action on own to get information to help reach objectives or clarify problems.
   - Does personal research on how to provide a product or service.
   - Consults experts for business or technical advice.
   - Seeks information or asks questions to clarify what is wanted or needed.
   - Personally undertakes research, analysis, or investigation.
   - Uses contacts or information networks to obtain useful information.

v) **Concern for High Quality of Work :** Acts to do things that meet or beat existing standards of excellence.
   - States a desire to produce work of high quality .
   - Compares own work or own company's work favourably to that of others.

vi) **Commitment to Work Contract :** Places the highest priority on getting a job completed.
   - Makes a personal sacrifice or expends extraordinary effort to complete a job.
   - Accepts full responsibility for problems in completing a job for others.
   - Pitches in with workers or works in their place to get the job done.
   - Expresses a concern for satisfying the customer.

vii) **Efficiency Orientation :** Finds ways to do things faster or with fewer resources or at a lower cost.
   - Looks for or finds ways to do things faster or at less cost.
   - Uses information or business tools in improve efficiency.
   - Expresses concern about costs vs. benefits of some improvement, change, or course of action.

viii) **Systematic Planning :** Develops and uses logical, step-by-step plans to reach goals.
   - Plans by breaking a large task down into sub-tasks.
   - Develops plans that anticipate obstacles.
   - Evaluates alternatives.
   - Takes a logical and systematic approach to activities.

ix) **Problem Solving :** Identifies new and potentially unique ideas to reach goals.
   - Switches to an alternative strategy to reach a goal.
   - Generates new ideas or innovative solutions.

x) **Self-Confidence :** Has a strong belief in self and own abilities.
- Expresses confidence in own ability to complete a task or meet a challenge.
- Sticks with own judgement in the face or opposition or early lack of success.
- Does something that he says is risky.

xi) **Assertiveness :** Confronts problems and issues with others directly.
- Confronts problems with others directly.
- Tells others what they have to do.
- Reprimands or disciplines those failing to perform as expected.

xii) **Persuation :** Successfully persuades others.
- Convinces someone to buy a product or service.
- Convinces someone to provide financing.
- Convinces someone to do something else that he would like that person to do.
- Asserts own competence, realibility, or other personal or company qualities.
- Asserts strong confidence in own company's or organisation's products or services.

xiii) **Use of Influence Strategies :** Uses of variety of strategies to affect others.
- Acts to develop business contacts.
- Uses influential people as agents to accomplish own objectives.
- Selectively limits the information given to others.

xiv) **Monitoring :**
- Develops or uses procedures to ensure that work is completed or that work gets standards or quality.
- Personality supervises all aspects of a project.

xv) **Concern for Employee Welfare :**
- Takes action to improve the welfare of employees.
- Takes positive action in response to employees' personal concerns.
- Expresses concern about the welfare of employees.

Are these Competencies Independent?

All the competencies described above are instrumental in making a person successful entrepreneur. Through these competencies, we can descriminate between successful entrepreneurs and average ones. All these competencies are interrelated. Depending on the nature and content of these competencies they could be clubbed into various clusters. These competencies could be developed through systematic training.

Activity 2

Some people believe that it is the traits of a person that help him in succeeding as an entrepreneur. Look at the table below and list 6 characteristics that you think are most important for a person to have, in order to succeed as an entrepreneur. Also, list 6 traits which you think are the least important in this regard.

		Most Important	Least Important
1	High academic qualification	....	....
2	Physical fitness	....	....
3	Need to achieve	....	....
4	Ventivesomeness	....	....
5	Creativity	....	....
6	Competitiveness	....	....
7	Persistence	....	....
8	Patience	....	....
9	Leadership	....	....
10	Organising ability	....	....
11	Need to have power over others	....	....

12	Desire for money	....	....
13	Independence	....	....
14	Coverage	....	....
15	Positive outlook	....	....

2.4 DEVELOPING ENTREPRENEURIAL COMPETENCIES

Stage 1 : Understanding and Recognising
The first step towards acquiring a new behaviour is to understand what a particular competence means. With such an understanding one would then able to recognise the competence when someone exhibits the same.

Step 2 : Self Assessment
Having understood a given competence and having been able to recognise the same when someone else exhibits a given competence, the next step is to find out where one stands with respect to a given competency. In other words, does one possess a given competence and if so how frequently one exhibit the same in one's day-to-day activities.

In order to help one identify the level of one's competencies, enclosed herewith is a questionnaire, titled 'Self Rating Questionnaire' which one could answer and later on use the coding sheet attached to the questionnaire to understand one's level of competencies. The self-rating questionnaire is placed at Exhibit 1. Coding instructions of Self-Rating Questionnaire is placed at Exhibit 2A.

After coding, to know where one stands with respect to various entrepreneurial competencies, we suggest one does some introspection and answer some of the questions listed in Exhibit 2B labelled as "My Thoughts about my Competence Level".

Step 3 : Practice
Having gone through the above steps, one would be in a position to decide the competencies that are not a part of one's personality but one would like to acquire those competencies and strengthen others. By practice, we mean exhibiting a given competence in a variety of situations, both simulated and real. Help from a trained facilitator is called for to develop the competencies through practice in simulated situations.

Step 4 : Application in Real life Situation
Any new behaviour that one acquires would become a part of one's personality only when one applies the same on a continuous basis in various activities. In other words, there is a need to make efforts towards exhibiting all the competencies deliberately and consciously all the time even in the simplest activities that one performs.

Step 5 : Feedback
One's desire to acquire new behaviour, internalise and practice the same would be strong only when one understands the benefit of operating as per the newly acquired behaviour versus usual/old behavioural pattern. Hence, having understood a competence and having practised the same in a given situation one needs to introspect to find out how one's "new behaviour" or act of exhibiting a competence has been rewarding. Greater the benefit, more will be one's determination to continue exhibiting the competence in a variety of situations.

2.5 EXHIBIT 1

SELF-RATING QUESTIONNAIRE

Your Name ....

Company ....

Address ....

Date ....

Instructions

1. This questionnaire consists of 70 brief statements. Read each statement and decide how well it describes you. Be honest about yourself.
2. Select one of the numbers below to indicate how well the statement describes you:
   5 = Very well
   4 = Well
   3 = Somewhat
   2 = Very little
   1 = Not at all
3. Write the number you select on the line to the right of each statement. Here is an example :
   I remain calm in stressful situations. ___2___
   The person who responded to the item above wrote a "2" indicating that the statement described him or her very little.
4. Some statements may be similar, but no two are exactly alike.
5. Please answer all questions.

Write the number on the line to the right of each statement.

1 I look for things that need to be done. ________

2 I like challenges and new opportunities. ________

3 When faced with a difficult problem, I spend a lot of time trying to find a solution. ________

4 When starting a new task or project, I gather a great deal of information. ________

5 It bothers me when things are not done very well. ________

6 I give much effort to my work. ________

7 I find ways to do things faster. ________

8 I plan a large project by breaking it down into smaller tasks. ________

9 I think of unusual solutions to problems ________

10 I feel confident that I will succeed at whatever I try to do. ________

11 I tell others when they have not performed as expected. ________

12 I get others to support my recommendations. ________

13 I develop strategies to influence others. ________

14 No matter who I'm talking to, I'm good listener ________

15 I do things that need to be done before being asked to by others. ________

16 I prefer activities that I know well and with which I am comfortable. ________

17 I try several times to get people to do what I would like them to do. ________

18 I seek the advice of people who know a lot about the problems or tasks I am working on. ________

19 It is important to me to do a high quality job. ________

20 I work long hours and make personal sacrifices to complete jobs on time. ________

21 I am not good at using my time well. ________

22 I think about the advantages and disadvantages of different ways of accomplishing things. ________

23 I think of many new ideas. ________

24 I change my mind if others disagree strongly with me. ________

25 If I am angry or upset with someone, I tell that person. ________

26 I convince others of my ideas. ________

27 I do not spend much time thinking about how to influence others. ________

28 I feel resentful when I don't get my way. ________

29 I do things before it is clear that they must be done. ________

30 I notice opportunities to do new things. ________

31 When something gets in the way of what I am trying to do, I keep on trying to accomplish what I want. ________

32 I take action without seeking information. ________

33 My own work is better than that of other people I work with. ________

34 I do whatever it takes to complete a job. ________

35 It bothers me when my time is wasted. ________

36 I try to think of all the problems I may encounter and plan what to do if each problem occurs. ________

37 Once I have selected an approach to solving a problem, I do not change that approach. ________

38 When trying something difficult or challenging, I feel confident that I will succeed. ________

39 It is difficult for me to order people to do things. ________

40 I get others to see how I will be able to accomplish what I set out to do. ________

41 I get important people to help me accomplish my goals. ________

42 In the past, I have had failures. ________

43 I take action before it is clear that I must. ________

44 I try things that are very new and different from what I have done before. ________

45 When faced with a major difficulty, I quickly go on to other things. ________

46 When working on a project for someone, I ask many questions to be sure I understand what that person wants. ________

47 When something I have been working on is satisfactory I do not spend extra time trying to make it better. ________

48 When I am doing a job for someone, I make a special effort to make sure that person is satisfied with my work. ________

49 I find ways to do things for less cost. ________

50 I deal with problems as they arise, rather than spend time trying to anticipate them. ________

51 I think of many ways to solve problems. ________

52 I do things that are risky. ________

53 When I disagree with others, I let them know. ________

54 I am very persuasive with others. ________

55 In order to reach my goals, I think of solutions that benefit everyone involved in a problem. ________

56 There have been occasions when I took advantage of someone. ________

57 I wait for direction from others before taking action. ________

58 I take advantage of opportunities that arise. ________

59 I try several ways to overcome things that get in the way of reaching my goals. ________

60 I go to several different sources to get information to help with tasks or projects. ________

61 I want the company I own to be the best of its type. ________

62 I do not let my work interfere with my family or personal life. ________

63 I get the most I can out of the money I have to accomplish a project or task. ________

64 I take a logical and systematic approach to activities. ________

65 If one approach to a problem does not work, I think of another approach. ________

66 I stick with my decisions even if other disagree strongly with me. ________

67 I tell people what they have to do, even if they do not want to do it. ________

68 I cannot get people who have strong opinions or ideas to change their minds. ________

69 I get to know people who may be able to help me reach my goals. ________

70 When I don't know something, I don't mind admitting it ________

2.6 EXHIBIT 2A and B

Exhibit 2A

SCORING SHEET FOR SELF-RATING QUESTIONNAIRE

Instructions

1 Enter the ratings from the completed questionnaire on the lines above the item numbers in parentheses. Notice that the item numbers in each column are consecutive : item number 2 is below item number 1, and so forth.

2 Do the addition and subtraction indicated in each row to compute each competency score.

3 Add all competency scores to compute the total score.

Rating of Statements	Score	Competency
____ + ____ + ____ + ____ − ____ + 6 = (1) (15) (29) (43) (57)	______	Initiative
____ − ____ + ____ + ____ + ____ + 6 = (2) (16) (30) (44) (58)	______	Sees & Acts on Opportunities
____ + ____ + ____ − ____ + ____ + 6 = (3) (17) (31) (45) (59)	______	Persistence
____ + ____ − ____ + ____ + ____ + 6 = (4) (18) (32) (46) (60)	______	Information Seeking
____ + ____ + ____ − ____ + ____ + 6 = (5) (19) (33) (47) (61)	______	Concern for High Quality of Work
____ + ____ + ____ + ____ − ____ + 6 = (6) (20) (34) (48) (62)	______	Commitment to Work Contract
____ − ____ + ____ + ____ + ____ + 6 = (7) (21) (35) (49) (63)	______	Efficiency Orientation
____ + ____ + ____ − ____ + ____ + 6 = (8) (22) (36) (50) (64)	______	Systematic Planning
____ + ____ − ____ + ____ + ____ + 6 = (9) (23) (37) (51) (65)	______	Problem Solving
____ − ____ + ____ + ____ + ____ + 6 = (10) (24) (38) (52) (66)	______	Self-confidence
____ + ____ − ____ + ____ + ____ + 6 = (11) (25) (39) (53) (67)	______	Assertiveness

____ + ____ + ____ + ____ − ____ + 6 = ______ Persuasion
(12) (26) (40) (54) (68)

____ − ____ + ____ + ____ + ____ + 6 = ______ Use of Influence Strategies
(13) (27) (41) (55) (69)

TOTAL SCORE ______

____ − ____ − ____ − ____ + ____ + 18 = ______ Correction Factor
(14) (28) (42) (56) (70)

CORRECTED SCORING SHEET

Instructions

1 The Correction Factor (the total of items 14, 28, 42, 56, and 70) is used to determine whether or not a person tries to present a very favourable image of himself. If the total score on this factor is **20 or greater**, then the total scores on the 13 competencies must be corrected to provide a more accurate assessment of the strength of the competencies for that individual.

2 Use the following numbers when figuring the corrected score:

If the Correction **Factor score is :**	Subtract the following **correction number from the total score for each competency :**
24 or 25	7
22 or 23	5
20 or 21	3
19 or less	0

3 Use the page below to correct each competency before using the Profile Sheet.

COMPETENCY PROFILE SHEET FOR SELF-RATING QUESTIONNAIRE

Instructions

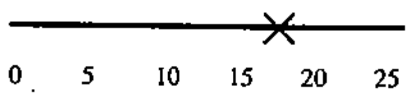
1 Transfer the corrected competency score to the profile sheet by marking an "x" at the appropriate point on the dotted horizontal line for each competency.

2 Draw a heavy line over the dotted horizontal line for each competency, from the left vertical line to the point you have marked with an "x". The heavy lines you have drawn graphically represent the strength of each competency.

3 The following is an example of how to create the profile sheet.

If the score for Initiative is 19, it will appear as follows :

Initiative



CORRECTED SCORE SHEET

Competency	Original Score	−	Correction Number *	=	Corrected Total
Initiative	____	−	____	=	____
Sees and Acts on Opportunities	____	−	____	=	____
Persistence	____	−	____	=	____
Information Seeking	____	−	____	=	____

Concern for High Quality of Work	____	–	____	=	____
Commitment to Work Contract	____	–	____	=	____
Efficiency Orientation	____	–	____	=	____
Systematic Planning	____	–	____	=	____
Problem Solving	____	–	____	=	____
Self-confidence	____	–	____	=	____
Assertiveness	____	–	____	=	____
Persuasion	____	–	____	=	____
Use of Influence Strategies	____	–	____	=	____
			Corrected Total Score		____

* This number depends on a person's Correction Factor Score and will be 7, 5 . 3 or 0. the same for each competency. Use the instructions on the previous page to determine the correction number.

BUSINESS SITUATIONS EXERCISE PROFILE SHEET

Competency

Initiative

Sees and Acts on Opportunities

Persistence

Information Seeking

Concern for High Quality of Work

Commitment to Work Contract

Efficiency Orientation

Systematic Planning

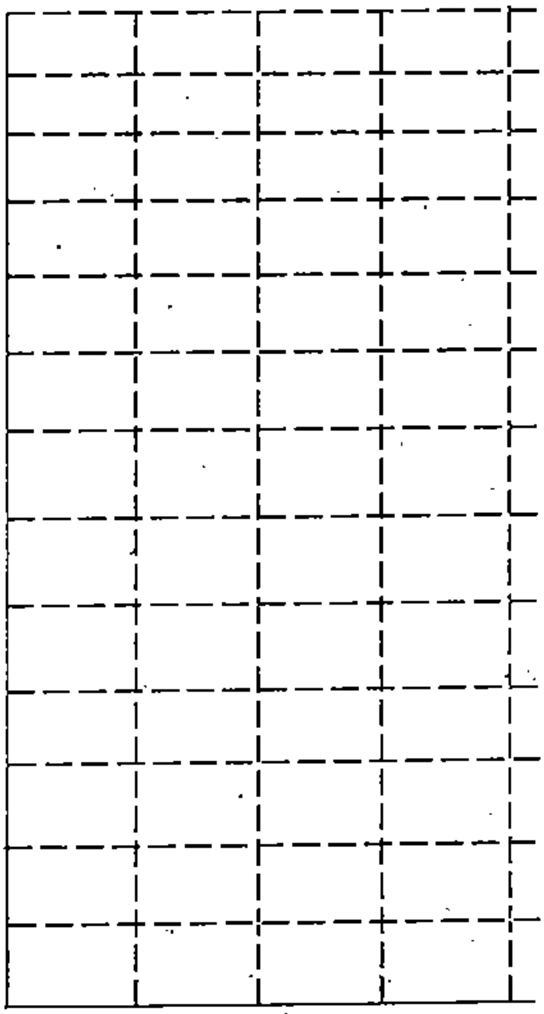
Problem Solving

Self-confidence

Assertiveness

Persuasion

Use of Influence Strategies



0 1 2 3 4

Competency Scores

Activity 3

Administer the self-rating questionnaire given in Exhibit 1 to some very successful entrepreneurs and some average ones. Develop the competence profile. Do the profiles differ significantly?

....

....

....

....

....

....

....

....

Exhibit 2B

MY THOUGHTS ABOUT MY COMPETENCE PROFILE

1 My first reaction on examining my score for each of the 15 competencies is as follows:

....

....

....

....

2 I seem to be least competent at the following:

....

....

....

....

3 Thinking back, the following incidents seem to have demonstrated my weakness in these areas:

....

....

....

....

4 The following seem to be my strongest competencies:

....

....

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....

5 Thinking back, the following incidents seem to illustrate my strength in these areas:

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6 During this course, I hope that I can make some improvement in the following competencies:

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2.7 SUMMARY

The entrepreneurial talent available in any society is also dependent upon the type of competencies associated with entrepreneurship. Studies in the field of entrepreneurial development indicate that qualities the initiative, sensitivity to environment, sense of work commitment and persistence arriving a lot of other qualities are positively associated with successful entrepreneurs. This unit discusses the concept, formation and development of entrepreneurial competencies, and also provides self-rating questionnaires to enable the measurement of entrepreneurial competencies.

2.8 SELF-ASSESSMENT QUESTIONS

1) What do you understand by the term entrepreneurial competency? How is the term relevant to entrepreneurship development?

2) Which 5 competencies according to the feedback you got from activity 3, rate highest as determinants of entrepreneurial success? Can you explain the significance of each for entrepreneurial success?

3) Describe the process of development of entrepreneurial competencies.

2.9 FURTHER READINGS

Richard E. Boyatzis, *The Competent Manager*, (John Wiley and Sons Inc., UN 1982)

Richard M. Hodgetts, *Effective Small Business Management* (Academic Press Inc., Harcourt, Brace Jovanovich Publishers)

UNIT 3 INSTITUTIONAL INTERFACE FOR SMALL SCALE ENTERPRISES

Objectives

After going through this unit you should be able to:

- discuss the government policy towards developing and promoting small scale industry, and small scale industry and small scale business.
- explain the role of the various Central and State Government bodies and other autonomous bodies in assisting the implementation of small scale industry and small scale business.
- discuss the various rules regulation and procedure relevant for small scale industries and small scale business.

Structure

3.1 INTRODUCTION

In response to its specific employment generation and income generation needs and the kind of capital resources available, India opted for a policy of development of the small scale sector, along with a heavy industrial sector. This unit discusses the policy framework for small scale enterprises and also describes the institutional infrastructure that has been developed to facilitate this sector.

3.2 INSTITUTIONAL INTERFACE—THE CONCEPT

The term institutional interface refers to a part of economic environment of industry and business consisting of authorities and institutions whose decisions and activities influence activities of different business units. The institutions could be government owned—statutory—semi-autonomous or autonomous. The authorities are generally governmental and in a sense wield governmental power granted to them in specific fields of activities. Since in Block one our major focus is on small enterprise and entrepreneurship development the institutional interface that we describe here is related to that sector of industry and business in India.

A business or industrial unit—enterprise in short—refers to the institutional interface essentially at three stages in its development viz. (i) inception i.e. establishment of an enterprise (ii) day-to-day operations which would mean day-to-day management and (iii) expansion and/or diversification. In this unit our emphasis will be on the institutional interface at the inception stage. To formulate the proposition, the question we are trying to answer is: How do policies and activities of the institutions discussed influence, provide assistance, resources and technical advice to an entrepreneur whose aim is to set up a small enterprise. The term small enterprise covers a range consisting of household, tiny and small scale units, small businesses and service establishments. They will be referred to hereinafter as SSI/SSE/Small Scale Industry and Small Scale Enterprises.

3.3 GOVERNMENT POLICY—INDUSTRIAL POLICY RESOLUTIONS

Major Environment

After attaining independence in 1947 India adopted economic planning as a method to achieve economic development. The pattern of planning that came to be accepted was of a mixed type meaning thereby that industrial units in the public and private sector will be operating in the economy. The mixed nature of the economy meant that on crucial areas the policy of the government was decisive and changes therein were of great relevance to industrial units. In the field of industry government's objectives and intentions were announced through five Industrial Policy Resolutions (IPRs). These resolutions were announced in 1948, 1956, 1977, 1980 and 1990 (For a summary, see Appendix A). We shall briefly state what each of the IPRs had stated about growth and development of SSI sector. It must be added that it is only recently that government policy and activities of the different interface institutions have covered SSE in addition to SSI. The earlier thinking was mostly addressed to SSI. The rationale for including SSE will be discussed subsequently.

IPR 1948

The industrial sector in 1948 was not different from the one existing in pre-1947 days and hence the SSI sector meant mainly rural industrial units, small job-cum-repair shops, units making agricultural implements, a few urban small units and handloom units weaving cloth. The greatest economic significance of these units to the Indian economy was their employment potential. It was this potential which called for protection through policy and the main thrust of IPR 1948 as far as the small scale sector was concerned, was protection.

IPR 1956

The second IPR was announced against the background of a bolder Second Five Year Plan, with a long term strategy for industrial and economic development. As to the SSI sector, the resolution envisaged a dual role viz. (i) manufacture of consumer goods such as cloth and (ii) manufacture of components for the newly established industry as part of the programme for long term industrial development. Thus, to the earlier emphasis of protection was added development. Industrial Policy for SSI aimed at "Protection plus Development". IPR 1956 in a manner initiated the modern SSI in India.

IPR 1977

The next IPR was announced after a lapse of two decades. During the preceding decades, two major problems had been witnessed. First was the lopsided industrial development—large, medium and small scale industries had become more of an urban phenomena and the other was large scale unemployment — the issue of urban and rural, educated and uneducated unemployed had started becoming difficult.

This situation led to a renewed emphasis on promotion of typical employment generating small scale industry, located in rural areas and small towns. As a formula it was: scale of output should be small, location semi urban/rural and technology, labour intensive.

This was the IPR which assigned a positive role to SSI in terms of wage employment of worker and self-employment of the entrepreneur. This was the IPR which therefore, offered a wider perception to policies and programmes for SSI development. To the earlier thrust of protection (IPR 1948) development (IPR 1956) this resolution added promotion. The SSI sector was thus, to be protected, developed and promoted.

IPR 1980

This IPR re-emphasised the spirit of the IPR 1956 with its strategy of large scale, high technology and heavy investment based key or basic industry. Nevertheless, the SSI sector remained as perhaps the best sector for generating wage and self-employment based opportunities in India.

IPR 1990

This IPR was announced during June 1990. Its basic aim is to introduce measures of economic liberalisation and simplified rules and procedures with a view to enhancing the technological base of industry and accomplishing higher levels of output. It gave a special emphasis on the SSI/SSE sector where employment opportunities are likely to be high. In order to enable the SSI units to update their technology the investment limit of SSI has been raised to Rs. 60 lakhs (See Appendix B).

Activity 1

Visit an entrepreneur who has just set up a unit to find out the type of financial assistance received by him. Determine also the policy resolution under which he got the assistance.

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3.4 THE ADMINISTRATIVE AND INSTITUTIONAL SET UP

Government policy resolution and programmes based on the same, need a proper administrative and institutional set up. Right from the time of IPR 1948, this has engaged the mind of the government. As such the following set up helps the SSI sector and for its operations SSI is divided into two major groups: (i) the Small Industry Development Organization (SIDO) and (ii) the Non-SIDO. The latter was described by different terms like unorganised, informal or non-urban, depending upon the point of view from which they are described. The SIDO is centralised in the Office of the Development Commissioner Small Scale Industry (DCSSI). At the level of state there is Director of Industry (DI) or Industries Commissioner (IC). In the states again District Industry Centre (DIC) is an important extension in the field of industry. For any individual intending to obtain information and help in district based towns or villages, DIC is easily the best office. DIC has managers to help small entrepreneurs in the areas of raw material marketing and infrastructure.

In case of small units in the unorganised sector there are autonomous boards such as Khadi and Village Industries Commission, Handloom Board, Powerloom Board, Silk Board, Coir Board and All India SSI Board. These boards help units in respective industry in areas like establishment, operations—mainly raw materials, technical help, marketing help and designs. It must be remembered that a smaller unit working either under SIDO or Non-SIDO set up is governed by the Central Government policies on issues such as excise differential, price preference or marketing assistance. It is for administrative purposes, among others, that these units are placed under different organizations. As such, all such industrial units are under the purview of boards and the assistance they provide.

In addition to the above organizations whose purview is overall, at the level of the state separate agencies deal with specific problem areas as follows:

Infrastructure development corporation for providing plots/industrial sheds, water, power and road, *financial corporation* providing term loans to entrepreneurs. For small entrepreneurs there is a separate financial corporation. Thus, in Gujarat, the Gujarat State Financial Corporation provides term loan up to Rs. 90 lakhs, while for term loans exceeding this amount there is the Gujarat Industrial Investment Corporation. This set up exists in many other states.

Assistance for raw material, plant and machinery is provided by a separate corporation viz. Small Industry Corporation.

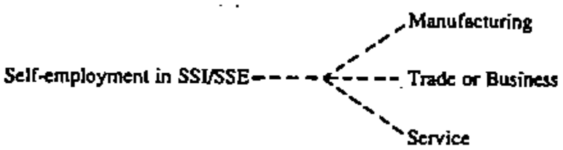
States also have technical consultancy organizations to advise and solve problems faced by entrepreneurs. These entrepreneurs may be large, medium or small.

Some states have programmes for preparing or training entrepreneurs. Some national institutions are also involved in designing and imparting such training programmes.

Industrial Policy in Operation

An entrepreneur who wishes to set up a small unit of his own may however, like to know how the Industrial Policy is actually implemented. In other words, how will his unit come under the purview of industrial policy at different stages. For this we should firstly *lay bare the entrepreneurial process* and then suggest a tentative framework for establishing linkage between some of the following areas.

Information : An enterprise can be viewed from the point of view of an entrepreneur or the institution of the interface. Since in this unit our focus is mainly on the institutions of the interface, we shall place greater emphasis on their activities. The foremost area is Information and in the first place it should enable an individual to make a choice as between different self-employment opportunities. The opportunities for self-employment are represented by means of a diagram below:



Information on self-employment based opportunities in any one of the above areas should be available from the following institutions:

(1) Director of Industry of the State or District Industries Centre.

(2) State Finance Corporation particularly their Small Business Cell.

(3) Nationalised Commercial Banks, their Small Business/Enterprise Department.

(4) State Directorate of Cottage Industries.
(For details see Appendix C).

In addition to the above some states have published, from time to time, list of Bankable Schemes for SSE. These are indeed very small enterprises or service establishments and are meant essentially for self-employment of the individual. A few such Bankable Schemes include Detergent Soap/Powder, Hair Oil, Washing Soap, Carpentry Shop, Diesel Oil Engine Service-cum-Repair Shop etc., for rural areas. For urban locations the list would include xeroxing centre, beautician's shop, TV service centre, furniture designing centre, etc.

The objective in providing such lists is that, very often persons desirous of taking to self-employment as a positive career alternative, lack basic information on what alternatives are actually available. Taking the length and breadth of the country, its vast rural and backward areas lack of relevant information would seem to be a basic lacuna. One of the activities of the interface institutions therefore, is collecting and disseminating information.

Other Institutions: The major objective of Government Policy with regard to the small scale sector—both small scale industry and other small businesses has been employment. The policy and a variety of measures of central as well as state governments aim at promoting these enterprises. We have noted the role played by the infrastructure institutions in handing out information. This may be regarded as the starting point. It would enable an individual to choose from among alternatives. But an enterprise is not all information. In establishing the same, regardless of size, the individual needs other resources too, and one of the most important of these resources is finance. Finance is described as the backbone of an enterprise. Let us describe the various financial institutions which can help a small enterprise.

Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India—the apex bank for small scale industries—extends assistance to SSI units through various schemes. The activities of SIDBI are as under:

The immediate thrust of SIDBI is on :

i) initiating steps for technological upgradation and modernisation of existing units;

ii) expanding the channels for marketing the products of SSI sector in domestic and overseas markets;

iii) promotion of employment-oriented industries especially in semi-urban areas to create more employment opportunities and thereby checking migration of population to urban and cosmopolitan areas.

Finance for SSI/SSE

With reference to the sector of small enterprises—both industry and business—all-India financial institutions do not have a direct role to play. Finance as an important resource is provided mostly by state based institutions. Two such institutions carry out this activity at the level of a state in India: One, the State Financial Corporation—an autonomous state-based institution and two, nationalised commercial banks. One could add to these a third set of institutions—the cooperative banks. These are either location based i.e. residents of a location have formed a cooperative bank, or industry/trade based. The latter could be weavers' cooperative bank or fishermen's cooperative bank, etc. Prior to nationalisation of commercial banks their field of activity was mainly collecting deposits from the public and extending short-term loans to business and industry. The whole activity was of a supportive character with some promotional element. After the nationalisation of banks two most important changes took place. One: the objectives of policies and procedures underwent many significant changes—banking became more and more of a service industry and two: with an extensive programme of opening branches these services became available almost everywhere in the country. The promotional objective in the new framework is on creating of new openings in self-employment, small industry and enterprises. The localised and activity-based cooperative banks have added to this.

The help that the banking institutions extend to the small sector lies in two major areas, term loan of a small amount, for setting up a small enterprise and working capital i.e. funds required for day-to-day running of an enterprise. A typical programme of extending financial assistance by a nationalised banks would include the following:

Financing of Small Business Activities

- Finance to Retailers
- Finance to Transport Operators
- Finance to Professional and Self-employed individual
- Finance to Business Enterprises

Among the above there is no upper limit on the amount of finance given for transport operators, professionals and self-employed individuals. The latter can include a most extensive type of activities such as pathological laboratories, eye clinics, computer based data processing services etc. Financial limits generally apply in the category of retail traders and business enterprises. The loans are given for (a) acquiring or repairing business premises (b) purchase of furniture, fittings equipments and vehicle accessories and (c) for meeting the cost of vehicle inclusive of cost of spares with sales tax, insurance and registration. Cash credit facilities are provided for meeting working capital. Small businesses are known to borrow from non-institutional sources at higher rates of interest. Such loans can be liquidated with the help of bank funds.

Offices of nationalised commercial banks have a department or cell devoted to small businesses and detailed information including the forms of application and conditions for the loans are given in them.

An important aspect of the activities of the cooperative banks should be added here. Most of the lending of such banks are based on personal knowledge of the borrowers. Security, guarantee and such other questions are not emphasised very much. This is because the area of operation of such banks is a small town, a particular trade or activity and hence the management has fairly detailed knowledge and information about the borrower bank. Due to this several small borrowers have been able to start many a self-employment oriented activity.

The borrower must however, bear in mind one very important aspect in dealing with banks. He must fully understand the terms and conditions under which a loan is sanctioned and the true implications of these on his business/service/manufacturing unit. In some cases, the financial institutions themselves explain these implications to the borrower which represent the true kind of promotional activity. Against the background of vast unemployment in the country—the urban, rural, educated, uneducated—and the urgent need to provide solution to this through schemes of self-employment, financial institutions and banks are getting equipped with several promotional extension programme and literature. It is in the interest of the potential borrower to avail of such programmes and promotional literature so that he is better equipped to utilise the borrowed funds.

A manufacturing servicing or trading unit will need merchandise and raw material of all kinds. In addition to this a manufacturing unit would require some machines, tools and equipment, what kind of interface institutions come to the assistance of an intending small entrepreneur should be discussed. In the case of all the three types of activities the foremost requirement would be land and building. Save for the individual who is using his own premises the rest would have to locate their activities somewhere. For manufacturing and business units open plots or sheds may be available from (a) state industrial development corporation (in some states these are known as infrastructure development corporation) (b) local authorities-from Panchayats and Municipalities or (c) private estate development authorities. The first category of institutions is a well-established institutional arrangement of the day. Open plots or built shed are available either on down or total payment or under the hire-purchase scheme. Payment of instalments over a given period will end in ownership of the shed by the occupant.

Another important requirement would be machines, tools and equipment, in technical jargon plant and equipment. This facility next to the building, enables you to undertake and carry on your manufacturing operations.

With regard to plant and machinery the National Small Industries Corporation (NSIC) and its branches offer these on hire-purchase terms. In terms of the existing practice of one of the states, the hire-purchase scheme of NSIC operates actually through the loan sanctioned by the state finance corporation. A part of the loan—which is the cost of plant and machinery, is treated as part of the hire-purchase scheme.

In the same way the state based small industries corporation has schemes to meet raw material requirements of small manufacturing units, particularly scarce and/or imported raw materials. With regard to the latter—imported raw material—in some case the linkages may be found in two important corporations like State Trading Corporation and Mineral and Metals Trading Corporation. But such linkages may not generally be relevant with reference to typical small self-employment based units.

Markets for the Products: Manufacturing small units face the difficulty of marketing their products mainly because of two reasons. In the first place there are several lines in which products of large and small units have to compete with each other in the market. In such situations the latter always suffer and in order to help such units, in selected product lines, special purchase programmes have been announced by the government. These programmes extend subsidy to SSI products so that they can compete with some strength. Such lists should be available with the director of industry of the state, the state small industry corporation and the district industry centres. In some states a list of state-based product is also available.

The recent emphasis of policy is to encourage both small scale industry and small business and trade which provide self-employment opportunities in the first place. Small businesses have limited requirements of plant, machinery and tools and most of the financial requirements are met by nationalised commercial banks. Most of the banks have announced liberalised loan schemes, entrepreneur schemes, equity fund scheme, and composite loan scheme for artisan based village and cottage industries. As an illustration we give below outline of what a liberalised loan scheme would be offering.

A LIBERALISED SCHEME

The Bank provides finance to small scale industries on concessional terms under this scheme.

1 Eligibility :

Any individual, proprietory concern, partnership firm, Joint Hindu Family concern, Industrial Cooperative-Society, Private Limited Company, or any other registered association that can qualify under the definition of small scale industry is eligible under the scheme.

2	Bank Finance and Facilities Purpose	Facility
A	To meet the capital cost of Project for acquisition of land, building, plant and machinery, technical knowhow, etc.	

	i) In case full payment	Term Loan [Term Loans are normally repayable over a period of 5-7 years including an initial moratorium (for repayment of loan instalments only) of 6 to 12 months depending upon the expected cash accruals, gestation period, etc.]
	ii) In case the supplier is willing to accept payment in instalments spread over a long time.	Deferred Payment Guarantee
B	For meeting working capital requirements	
	a) For purchase of raw material	– Guarantee to supplier for the bills for supply of raw materials drawn by him (Letter of Credit) – Direct payment to the supplier
	b) For stocking of raw materials up to reasonable limit to meet normal consumption requirements	– Cash credit against raw materials
	c) For goods-in-process to suit the production schedule	– Cash credit against goods-in-process
	d) For stocking or finished goods up to reasonable levels meeting delivery schedule/off-the shelf delivery	– Cash credit limit against finished goods
	e) Financing of receivables	– Cash credit limit against book debts/usance bills – Cash credit against supply bills drawn on government departments – Demand Bills and cheques purchasing facility – Usance Bills discounting facility – Discounting of usance bills drawn on buyers under the IDBI's Bill Rediscounting Scheme (to the manufacturers of capital equipment for effecting sale on deferred terms)

Trade-Industry Association

Apart from statutory and autonomous institutions and development corporations there are several trade-industry and business associations which provide information and support to industrial and business unit. To start with the main focus of these activities was large industrial and business units but along with recent development and emphasis on small units these institutions have also broadened their activities. Thus, presently every industry and major product lines have an association. The product line may be engineering, chemical or plastic. You will find a local, state level and regional or national level organization to represent business interests of the members. Such association through periodic seminars or meetings release information on the state of the particular industry, its problems and prospects of growth which could be used by small unit owners and those who want to take to the line. A national level organization like All India Manufacturer's Organization (AIMO) has panels or subgroups of every manufactur'ng industry such as metal based, plastics, chemicals etc. While these organizations easily provide a platform for representing problems to the relevant authorities they have slowly begun to recognise their development-cum-promotional role.

Activity 2

Visit an SSI entrepreneur to find what assistance is he getting in marketing his product. Also try to establish the policy for the same.

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3.5 SUMMARY

Based on the foregoing descriptions of institutions and their activities an enterprise should be in a position to locate itself as surrounded by an environment. This environment consists of policies and authorities, institutions and corporations aiming at providing infrastructural inputs and resources and a host of industry-trade-business based voluntary associations. Their policies, measures and programmes are relevant to an enterprise to the extent these influence decision-making and problem areas of enterprises. A set of acting and interacting forces could be perhaps visualised by each unit with reference to its activities and decision. It should now be possible for us to understand the nature and concept of interface institutions.

3.6 SELF-ASSESSMENT QUESTIONS

1 Discuss the development of the policy towards SSI through the different industrial policy resolution. What do you think is the major feature of the 1990 policy resolution with respect to SSI.

2 Describe the administrative set up of the SSI sector.

3 What is the role of SIDBI ? Discuss.

4 How do trade industry associations, in the context of SSI's, facilitate development ?

3.7 FURTHER READINGS

Industrial Policy Resolution, Govt. of India Publication

Rudder Dutt and K.P.M. Sundaram, *Indian Economy*, S. Chand and Co. (Pvt.) Ltd., New Delhi, 1989

Vasant Desai, *Management of Small Scale Industries*, Himalaya Publishing House, New Delhi, 1990

3.8 APPENDICES

Appendix A

Industrial Policy Resolution—A Summary

Date	Main Objective	Principal Measure	The SSI Universe
IPR 1948	Protection	Raw material Cheap power Technical advice Marketing of products Safeguarding against excessive competition from large units	Village-based small enterprises Repair-cum-job shops Units using local market, raw material labour. Hence locally self-sufficient
1956	Protection plus development	Protect artisan based non-tech. enterprise Develop modern SSI for Industrial and consumer goods. Provide capital and skills. Develop export based units. Achieve regional balance through SSI. Package of assistance and incentives infrastructure, technological upgradation Reservation of items for SSI	Tiny/cottage rural units Modern SSI units in urban areas Units employing labour intensive technology. New entrants to SSI—new entrepreneurs. Ancillary units. Modern SSI
1977	Protection plus Development plus Promotion	Protect labour intensive technology. Promote small tiny units, promote non-urban location, promote new first generation entrepreneurs, Decentralised production	-do-
1980	Protection plus Development plus Promotion	Protect labour intensive technology, promote small tiny units, promote non-urban location, promote new first generation entrepreneurs. Decentralised production, Nuclear plant for SSI growth, Reservation products for SSI	-do-
1990		Promotion of SSI and agro-based industries Reservation of Products 836 and new lines to be identified, Central investment subsidy—rural and backward areas. Technology centres for modernisation, Small Industry Development Bank, SIDBI. Facilities of KVIC and KVI boards to be expanded to help artisans in marketing. Agro-processing industry to receive high priority.	-do-

Appendix B

Main Provisions of the IPR 1990 as Applicable to Small Scale and Ancillary Industries

1 The policy raises the investment ceiling in plant and machinery for small scale industries to Rs. 60 lakhs from the present Rs. 35 lakhs.

2 Correspondingly, for ancillary units, the investment ceiling has been raised to Rs. 75 lakhs from the present Rs. 45 lakhs.

3 In order to enable small scale industries to play an important role in the total export effort, the small units which undertake to export 30 per cent of the annual production by the third year would be permitted to step up their investment in plant and machinery to Rs. 75 lakhs.

4 The investment ceiling for tiny units has been increased to Rs. 5 lakhs from the present Rs. 2 lakhs. However, with regard to their location, the population limit of 50,000 as per the 1981 census, would continue to apply.

Appendix C

Institutional Set-up for Small Industry Development in India

Note : In describing these institutions greater emphasis is given to the state-based institutions.

A. NON-FINANCIAL

I. National Level

a) Small industries Development Organisation (SIDO)
- Policy formulating, coordinating and monitoring agency

b) National Small Industries Corporation (NSIC) with five regional offices
- supply of machinery on hire-purchase basis
- registration of units for participation in the purchase programmes of the Central and State Governments and other central institutions
- Marketing assistance—internal and export
- Development of prototypes of machinery and equipment, and other facilities

c) Commissioner for Industrial Cooperatives—Coordination of policies for industrial cooperatives

d) Specialised Institutions : Training and Development
- i) National Institute of Small Industry Extension Training (NISIET), Hyderabad
- ii) National Institute for Entrepreneurship and Small Business Development (NIESBUD), New Delhi
- iii) Entrepreneurship Development Institute of India (EDII), Ahmedabad, Lucknow, Patna, Bhopal—promoted by IDBI, IFCI, ICICI and SBI
- iv) Central Institute of Tool Design (CITD), Hyderabad
  Training in the design and manufacture of tools, jigs, fixtures, dies and moulds
- v) Central Tool Room and Training Centres
  (at Ludhiana, Delhi, Calcutta and Bangalore)
- vi) Central Institute of Hand Tools (CIHT), Jalandhar—
  provision of improved technology, raw materials, designs and testing for hand tools industry
- vii) Institute for Design of Electrical Measuring Instruments (IDEMI), Bombay
- viii) Central Machine Tool Institute, Bangalore
- ix) Central Institute for Plastics Engineering and Tools, Madras and Ahmedabad (Ministry of Petroleum and Chemicals)
- x) National Institute of Foundry and Forge Technology, Ranchi

II. **State Level Institution**

a) Directorate of Industries
With a network of District Industries Centres at the district level, industries officers at the sub-division level and extension officers at the block level.
- registration of small scale units and recommending cases of large/medium industries to appropriate authorities
- raw material quota
- import quota
- financial assistance under the State Aid to Industries Act
- Industrial estates
- technical consultancy
- training of entrepreneurs
- industrial cooperatives
- compilation of statistics
- overall administration of the village and small industry sector and maintaining close liaison with the central and state level organisations concerned with industrial development

b) Small Industry Development Corporation
- supply of scarce raw materials through raw material depot
- machinery on hire-purchase
- marketing assistance
- joint ventures in the small scale sector
- entrepreneurship development
- trade centres
- industrial estates

c) Industrial Infrastructure Corporation
Industrial Area Development Board/Authority
- plans and develops industrial estates and industrial areas

d) Industrial Development Corporation
- promotion of industrial units in the medium and large scale including joint and public sector ventures
- planning and development of industrial estates and industrial areas (in some estates)

e) Industrial Investment Corporation
- finances medium and large units up to a certain investment ceiling with direct participation in share capital and underwrites new issues

f) Agro Industries Corporation
- supply of agricultural machinery/equipment on hire
- development of agro-based industries
- sale of agro-inputs like fertilisers and pesticides

g) Electronics Development Corporation
- promotion of industries in the field of electronics including joint sector and public sector projects

h) Leather Industry Development Corporation and other similar commodity corporations
   - development of specific types of village and tiny sector units relating to a particular trade

i) Rural Industries Marketing Corporation
   - Marketing of village industry products and provision of a variety of services needed by village and tiny units (Gujarat State has set up this corporation)

j) Industrial and Technical Consultancy Organisation (sponsored by IDBI/IFCI/ICICI)
   - technical consultancy services to small and medium scale projects

Appendix D

An Overview of the Small Scale Sector in India

The following tables provide an overview of the statistics relating to small scale sector in terms of their salient features, consumption of energy, percentage distribution of registered units, industry groupwise percentage distribution, advances to SSI sector and statewise classification of sick units.

Source : Small Scale Industries Facts and Figure Development Commissioner, SSI, Department of SSI, Agro and Rural Industries, Ministry of Industry, Nirman Bhawan, New Delhi-110001

Table 1
Sample Survey Estimates (1982-83)
(Salient Features of Small Scale Industries Sector)

A.	*Employment*	
	1 Average Employment per unit of which	15
	a) Average employment on regular basis	10
	b) Contract basis	5
	2 Major Industry Group which provided maximum per unit employment (regular)	Basic metal Industries (18 Persons)
B.	*Investment in Plant & Machinery*	
	3 Percentage of units having investment in plant & machinery less than Rs. 2 lakhs	89
C.	*Production*	
	4 Production per unit :	
	a) All Products	Rs. 4,95,000
	b) Reserved Products	Rs. 3,91,000
	c) Non-reserved products	Rs. 5,64,000
	5 Percentage increase in 1982-83 over 1981-82 of Production :	
	a) All products	9.08
	b) Reserved Items	12.73
	c) Non-reserved items	7.48
D.	*Energy Consumption*	
	Plant Annual Energy Consumption per unit	Rs. 20,126

Table 2
Per Unit Consumption of Energy Classified According to Major Industry Groups

Sl. No.	Name of the Industry Group	Average energy consumption per unit (Rs.)
1	2	3
1	Food products	17,629
2	Beverages, Tobacco & Tobacco products	17,905
3	Cotton Textiles including Hosiery	9,122
4	Wood products	4,637
5	Paper products including Printing	9,847
6	Leather products	5,784
7	Rubber & Plastic products	23,861
8	Chemical & Chemical products	34,490
9	Non-metallic mineral products	53,677
10	Basic Metal Industries	92,864
11	Metal products	11,389
12	Machinery & Parts except electrical	16,949
13	Electrical Machinery & apparatus	18,654
14	Transport equipment and parts	22,865
15	Misc. manufacturing industries	8,799
16	Storage & warehousing	1,55,652
17	Repair & services	3,604
	All Industries	20,126

Table 3
Percentage Distribution of SIDO Units Registered During January to December 1985 (State-wise)

Sl. No.	State/UT	No. of Units (%)	Employment (%)	Investment in plant & machinery (%)	Total fixed investment (%)	Capacity (%)
1	2	3	4	5	6	7
1	Andhra Pradesh	7.9	11.7	8.8	13.2	7.9
2	Assam	0.0	0.1	0.0	0.0	0.0
3	Bihar	1.6	1.7	1.8	6.8	8.5
4	Haryana	18.4	13.6	14.6	10.0	18.3
5	Himachal Pradesh	0.6	0.4	0.8	0.9	1.8
6	Jammu & Kashmir	0.3	0.7	0.5	0.3	0.3
7	Karnataka	12.7	11.9	11.3	12.1	26.8
8	Kerala	8.6	9.9	9.6	5.4	4.4
9	Madhya Pradesh	3.0	4.2	4.6	3.1	2.5
10	Maharashtra	0.4	0.8	2.9	1.7	0.9
11	Punjab	17.7	12.5	12.3	21.1	9.8
12	Rajasthan	8.2	6.3	10.2	4.2	2.5
13	Tamil Nadu	15.3	16.3	13.0	7.9	5.2
14	Uttar Pradesh	0.6	1.4	13.0	1.9	0.6
15	West Bengal	2.3	3.2	2.5	2.5	4.1
16	Delhi	2.4	5.3	5.8	8.9	6.4

Table 4
Industry Group-wise Percentage Distributions of SIDO Units Registered During January-December 1985
(All-India)

Sl. No.	Industry Group	No. of Units (%)	Employment (%)	Investment in P. & M. (%)	Investment Total (%)	Capacity (%)
1	2	3	4	5	6	7
1	Food Products	14.98	15.50	20.32	17.67	24.57
2	Beverages	0.86	1.99	0.84	1.98	0.53
3	Textile products	3.38	4.67	3.57	3.25	5.19
4	Wood products	8.23	6.37	4.62	5.27	8.27
5	Paper products & Printing	3.89	3.92	5.22	3.23	6.40
6	Leather & Leather products	4.03	2.34	1.75	1.67	3.46
7	Rubber & Plastic products	3.94	4.22	6.64	3.50	6.15
8	Chemical & Chemical products	3.88	5.60	6.68	5.66	4.96
9	Non-metallic Mineral products	4.31	11.94	10.74	6.84	5.22
10	Basic Metal Industries	2.38	3.62	6.55	9.13	4.92
11	Metal products	11.12	10.90	9.23	6.69	8.29
12	Machinery & Parts except electricals	25.88	18.32	13.99	25.85	6.06
13	Electrical machinery & parts	1.97	2.56	2.49	2.67	3.35
14	Transport equipments & parts	1.92	2.63	3.34	2.35	2.61
15	Miscellaneous Industries	1.25	1.27	1.13	0.56	0.34
16	Storage & warehousing	0.02	0.03	0.10	0.05	0.00*
17	Scientific research service	0.00	0.00	0.00	0.00	0.00
18	Repairing and servicing	7.86	4.07	2.45	3.55	9.68
19	Colour film processing	0.00	0.06	0.34	0.09	0.04

* Negligible.

Table 5
Advances to Total SSI Sector by all Scheduled Commercial Banks as on the last Friday of December 1981 to March 1989

(No. of A/cs in thousands)
(Amounts in Crores of Rs.)

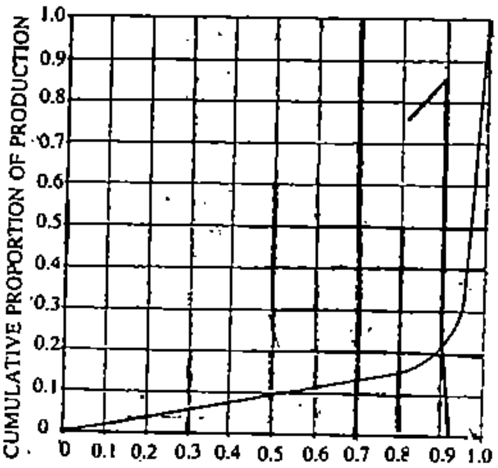
As on the last Friday of December	Total SSI Sector: No. of A/cs	Total SSI Sector: Amount Outstanding	Total priority Sector advances	Total Bank Credit	% of column 3 to 4	% of column 3 to 5
1	2	3	4	5	6	7
1981	961	3953.09	10802.85	29091.34	36.6	13.6
1982	1050	4464.32	12342.43	34229.59	36.2	13.0
1983	1244	5389.37	14881.93	41292.23	36.2	13.1
1984	1455	6537.18	18329.89	46295.60	35.7	14.1
1985	1642	7829.31	21631.39	52842.09	36.2	14.8
1986	1863	9127.25	25224.07	60312.04	36.2	15.1
1987 Ψ	2171	10166.32	27810.04	61324.50	36.6	16.6
1988 Ψ	2598	12308.67	32563.57	72174.54	37.8	17.1
up to March 1989 Ψ	2659	13129.86	34623.00	78192.78	37.9	16.8

Ψ Data related to Public Sector Banks only
Source: Reserve Bank of India

Table 6
State-wise Classification of Sick Small Scale Industries as at the end of December 1987

Sl. No.	State/UT	No. of units	Amount outstanding (Rs. Crores)
1	2	3	4
1	Andhra Pradesh	19,206	138.48
2	Assam	9,722	19.52
3	Bihar	14,151	73.81
4	Gujarat	5,728	129.91
5	Goa	673	9.74
6	Haryana	2,096	43.81
7	Himachal Pradesh	797	8.75
8	Jammu & Kashmir	2,647	11.33
9	Karnataka	8,463	107.72
10	Kerala	15,067	111.18
11	Madhya Pradesh	12,576	55.09
12	Maharashtra	15,401	331.72
13	Manipur	537	0.66
14	Meghalaya	120	0.49
15	Nagaland	16	0.25
16	Orissa	8,692	35.39
17	Punjab	2,434	44.97
18	Rajasthan	9,989	50.05
19	Tamil Nadu	30,942	193.15
20	Tripura	357	0.56
21	Uttar Pradesh	19,710	148.03
22	West Bengal	21,409	182.43
23	Andaman & Nicobar Islands	—	—
24	Arunachal Pradesh	11	0.02
25	Dadra & Nagar Haveli	6	0.15
26	Delhi	3,014	92.06
27	Mizoram	—	—
28	Pondicherry	271	1.96
29	Sikkim	4	0.22
30	Chandigarh	217	5.76
31	Daman & Diu	3	0.13
	TOTAL	2,04,259	1797.31

Concentration Chart of No. of Units and Production



CUMULATIVE PROPORTION OF NO. OF UNITS

NOTES

NOTES

Utter Pradesh
Rajarshi Tandon Open University

MBA-3.2

Management of New and Small Enterprises

Block

2

ESTABLISHING THE SMALL SCALE ENTERPRISE

BLOCK 2 ESTABLISHING THE SMALL SCALE ENTERPRISE

This block entitled Establishing the Small Scale Enterprise is devoted to the activities which form essential prerequisites for establishing a small scale enterprise. Every enterprise be it large or small begins as an opportunity identified, defined and assessed.

The first unit in this block on Opportunity Scanning and Identification discusses the processes for opportunity scanning for the small entrepreneur and the self-employed.

Before you set up an enterprise you will have to go through the exercise of assessing the market demand of your output, be it a service or a product. The second unit of the block entitled Market Assessment for SSE gives you an idea of the basic marketing concepts involved, and the methods you can use to assess market potential for your product.

Sometimes, application of particular technology or the possibility of exploiting locational advantage itself presents an opportunity for successful entrepreneurial ventures. These, then, become the cause for setting up the enterprise. On the other hand, whatever the reason for setting up of an enterprise, choice of appropriate technology and selection of site for the enterprise remain important managerial decisions. The last unit in the block is devoted to issues of selection of technology and site, and discusses the decision criteria, problems and techniques associated with the decisions.

UNIT 4 OPPORTUNITY SCANNING AND IDENTIFICATION

Objectives

After going through this unit you should be able to:

- define an entrepreneur and entrepreneurship
- explain what entrepreneures do and how do they do it
- define a business opportunity and discuss the best way to identify it
- elaborate upon the framework for identification of a small scale enterprise in India under the present conditions.

Structure

4.1 INTRODUCTION

In terms of the processes through which an enterprise gets established in India,this Unit discusses how an opportunity is identified by one who wishes to set up his own enterprise. The process by which an opportunity is identified is at times described as Opportunity Scanning or Sensing and Identification (OSI). An opportunity is identified and an enterprise established so that the person who carries out all the operations is self-employed, earns some income and in some cases profit. This whole activity is at times covered under one term entrepreneurship and entrepreneurs are also self-employed.

In this unit Entrepreneur and Entrepreneurship are viewed as synonymous with self-employment. Such an identification does not hold good under all circumstances but in order to explain OSI we have taken the terms as synonymous.

In a developing economy like India there should not be dearth of opportunities. One reads about innovative devices conceived and manufactured by engineers and technicians. One also comes across interesting success stories of entrepreneurs and businessmen describing a life span from rags to riches. Presently, in our country several schemes of promotion and assistance for setting up small scale units or small businesses by new or first generation entrepreneurs, are being implemented by the Central and State Governments. New product lines, new processes and new technologies have made India their home in only recent past.

We know from available literature on development **what** do entrepreneurs do but relatively little about **how** do they do it.

Let us begin by stating what do entrepreneurs do. Entrepreneurs engage themselves in the following three interrelated activities viz.:

a) Identification of bussiness opportunity.
b) Establishment of an enterprise based on the opportunity. Entrepreneurs also engage in a subsequent activity viz.
c) Managing the enterprise as a profitable and growing concern.

Activity (c) however, is not discussed in this unit though many of its implications will be found in identification of a project. We in this unit deal with (a) and (b) above.

The main focus of the unit is an **Opportunity** and how to identify the same. The term opportunity also covers a product or project and hence identification of a product or project or opportunity,all these three terms are used as synonyms.

4.2 UNDERSTANDING ENTREPRENEURSHIP

Entrepreneurship can be understood by answering the two questions of **what** and **how** but it would be clear that it is confined to practice, it is an action and decision oriented practice. Hence, one of the crucial areas for us to understand is what is an entrepreneurial decision. For this unit such a decision primarily relates to OSI. This is because large part of the success of an entrepreneur depends upon the opportunity. The opportunity again could relate to product, technology, market or organisation. In this way entrepreneurial dicisions turn out also to be developmental decisions.

Let us now understand an entrepreneur and qualities he possesses. One author has described the qualities of an entrepreneur as follows:

i) A strong desire for independence and ability to stand alone;
ii) Drive and energy and organising ability;
iii) A desire to diversify, expand and innovate;
iv) Technical and managerial competence;
v) Above average intelligence; and
vi) Capacity to take risks.

Above qualities have been found in successful entrepreneurs irrespective of country, industry, size, product line and cultural background of the entrepreneur. It would mean that these qualities have an element of universality.

Activity 1
Survey a few successful as well as struggling entrepreneurs. Using the questionnaire given in Unit 2 or one of your own, identify five qualities of entrepreneurs that set them apart. Also ask the entrepreneurs themselves to rate these qualities in order of importance.

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4.3 ALTERNATIVE FIELDS OF SELF-EMPLOYMENT

An individual who wants to take to self-employment would in the first place like to look at the universe of self-employed persons. He may find that different persons are self-employed in one of the following fields of business and economic activities. This can be described as the first scanning of the universe of self-employment.

Self-employed Individuals

(1) Industry	(2) Trade	(3) Commercial Services	(4) Professional Services
Transforming raw materials into finished products with the help of machinery i.e. manufacturing.	Buying and selling of products or consumables at a price.	Banking,Insurance, warehousing, Transport Agency work etc.	Engineers,Chartered Accountants, Architects,Doctors, Consultants, Beauticians.

The above can be described as career alternatives in self-employment. It will also be :lear to the reader that alternatives (1) and (2) would demand less of professional jualification as against (3) and (4). When we refer to OSI we shall keep (1) and (2) n our mind. Industry and trade are very inclusive sectors because manufacturing and rading activities will cover a vast number of items. For example, if we take the sector of small scale industry, Industrial Policy of the Government of India has reserved a otal of 836 products for exclusive manufacture by small scale industrial units. In a imilar manner items to be traded in would reveal almost an inexhaustible list. The juestion therefore still remains unanswered even when someone identifies industry or rade as the activity for self-employment—**in industry which product and in trade vhich item.** By describing the above alternatives we have only made the broad lternatives available and for us alternatives (1) and (2) are more relevant as against 3) and (4). Let us now discuss OSI in a more detailed manner.

ctivity 2

Contact 10-15 self-employed individuals. Classify them according to Figure-1. Question them to find out why they chose to go in for this particular stream among ie SSI opportunities open to them.

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4 IDENTIFICATION OF AN OPPORTUNITY

spite of increasing literature on lives of entrepreneurs and entrepreneurship velopment comparatively little is known about how an entrepreneur identifies an portunity. It is therefore, somewhat difficult to state in any categorical manner as how an intending entrepreneur should proceed. What is needed is a step-by-step count of how should one undertake such an activity. Literature on management ence, particularly those areas which deal with business policy, corporate planning 1 strategy formulation and implementation do however, offer useful insights into nagerial processes which are at times close to entrepreneurial pursuits.

dentifying his opportunity an intending entrepreneur like an individual inessman is required to understand the environment in which he would operate. the opportunity stage again government policy and the market for the duct/service would be the first to be taken for examination. This is generally ned as the external environment. Government policy for large or medium industry egulatory but for small industry it is both developmental and promotional.

major tools which our entrepreneur uses in this activity—OSI—are two viz. ming of his environment and assessing his own strengths and weaknesses in tion to opportunities in the market and competitive threats to the same. The ner can be a more general, all inclusive activity while the latter is a more specific situation-oriented activity. This is known in managerial jargon as SWOT Analysis ming thereby Analysis of Strength and Weaknesses on the subjective side and portunities and Threats in the market or the objective side. These tools are important are generally employed in the working of a business unit. But they can be extended areas about setting up of an enterprise and likewise identifying an opportunity.

and How of a Small Enterprise?

important tool in the identification of a business opportunity is the SWOT ysis. Let us now enumerate why and how are small enterprises established. In a e this enumeration is parallel to SWOT analysis. Analysis of factors which have led individual entrepreneurs to set up their small enterprises reveal a surprising degree of uniformity the world over. A small entrepreneur, the owner-manager of a small unit, enters this world because of:

a) love for doing independent business—or being one's own boss;
b) small business provides scope for taking initiative, organising activities and a kind of freedom which owner-managed small units alone can offer.
c) self-employment being an income generating activity, as an alternative to wage employment;
d) the flexibility in several operations which again is available in a small unit.

Another set of data on how were typical small scale units set up by identifying an opportunity reveals the following factors. This data is based on Indian small industry.

- entrepreneurs have selected products based on their own experience or their partners experience in the line;
- entrepreneurs have selected products based on the expansion/diversification plans of their own or any other on-going business known to them;
- entrepreneurs have selected products which are likely to have ready demand either in the local or regional market.
- entrepreneurs have selected products whose imports are banned or controlled by the government. This factor has been found applicable in identification of opportunities in small, medium and large scale industrial units;
- entrepreneurs have selected products which show high profitability;
- entrepreneurs have selected products based on certain specific advantages available to that product – such as, reservation of product lines for small scale units, certain regions or locations;
- entrepreneurs have selected product lines guided mainly by changes in certain aspects of industrial policy—more specially change in control and regulation of prices of raw material or products.
- somewhat similar to the above is the situation when entrepreneurs come to know of a product line as a result of reports by government committees on policy. Entrepreneurs' selection of computers or electronic products can be attributed to recent approach of government policy to these products.

Taking the two sets of factors we can say that the entrepreneurs have moved in a certain manner. The opportunity— product or service—appears to emerge through an interaction between the immediate or related environment of the entrepreneur to the somewhat remote or unrelated aspects of environment. We can also view it alternatively as proceeding from the more specific to general or may be micro to macro part of the environment. What appears to take place is an opportunity envelope with positive and negative or favourable and unfavourable factors attached to different opportunities. This envelope tells us how is an opportunity finally identified by an entrepreneur.

The combination of factors in such an envelope is not, in any sense, a unique or unusual combination. Our main concern in collecting these factors is to isolate the more important general factors—factors which seem to be generally applicable – and another category of factors which are specific to any opportunity or opportunities.

The above two methods of analysis can be placed in an alternative framework of scanning the environment and the individual comparing himself against the environmental subsets. As has been pointed out, the individual refers to the 'immediate' and the 'remote' environment. More accurately, his own strengths and weaknesses arising from the immediate environment in relation to the remote environment. Now, in India this remote environment, or large part thereof, is government policy and the market for the product. It is an interaction between the immediate and the remote environment which seems to explain, even in a rudimentary way, how opportunities or project ideas may be generated. It is a process of back and forth, as it were and the individual may be in a position to monitor his thinking.

Hen or Egg

In idenfifying an opportunity the entrepreneur passes through several processes. Some leading to enchantment and others to disenchantment. At one stage he likes the opportunity, at other he turns his mind to another. Nevertheless, two stages can be clearly located. In stage one, the entrepreneur tries to generate ideas or opportunities and in stage two he identifies the **opportunity.** In stage one most of the entrepreneurs are likely to encounter a situation resembling the Hen or Egg controversy. Ask any one who wants to select a project; his obvious answer would be a **"a project having a good market"**. Now, how without knowing the product could one determine the market? Whose market will you find out without deciding the item? It is necessary therefore to find a way out of this tangle. One of the methods employed by experienced entrepreneurs is to generate ideas about a few projects.

In such an attempt he makes use of his experience, background, contacts, observations, informations obtained from friends, development agency, policy of the government, schemes of concessions and incentives. All of these, put together, may offer a few ideas to be examined as opportunities.

We give below two situations to explain what has been discussed.

In **Jana Aranya** of Satyajit Ray there is a sequence in which two co-students Khokan and Bishuda are seen conversing with each other. Khokan is searching for a job while Bishuda is running his own business. Bishuda advises Khokan to observe the market and supply what the consumers want — what they are prepared to pay for.

A second situation is as follows:

Ashwin works in the purchase department of a state-owned road-transport corporation. As such, he knows about many components and spares which are being purchased. Having been in this department for many years he also knows which components are purchased in large quantities and more often. Being an engineer he turns his mind to the prospects of manufacturing some of them.

In the above two situations which one, do you think, is at the idea stage and which one at the opportunity stage. Alternatively, what is the difference between opportunity sensing and opportunity identification. This distinction is very important for those who are **consciously** making an attempt to identify an opportunity.

Imagine that as a result of the above analysis you have been able to prepare a list of the following opportunities. These are:

1) Nails, hinges and industrial fasteners (industry)
2) Cold storage services (service based business)
3) PVC moulded shoes (industry)
4) Xeroxing unit (service based business)

This is the smaller list from which the final opportunity/project will be selected. This can be described as the "zeroing in process". The stages through which you pass may be described by different expressions, such as "entrepreneurial scanning for projects", "entrepreneurial selection matrix", "entrepreneurial musings", "entrepreneurial rambling", etc. Whatever description you might prefer, the activity involves some of the major steps described above.

Activity 3

Going back to the sample you took for Activity 2, discuss with the entrepreneurs to find out exactly how they identified their opportunity.

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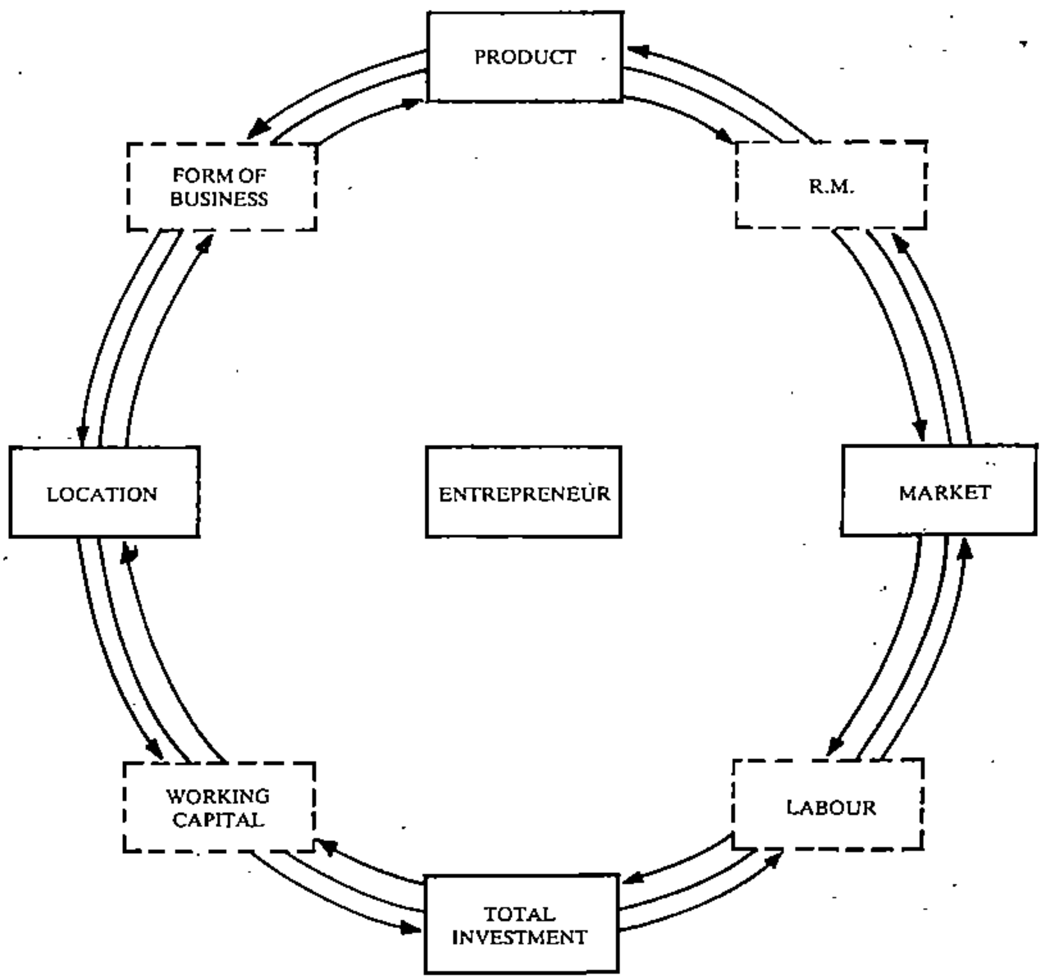
4.5 THE ZEROING IN PROCESS – FINAL STAGE

How should the intending entrepreneur arrive at the final project? What additional processes and criteria of selection should he use? In several respects the final selection should follow the course of action adopted in the previous stages, but with a difference. The examination of each of the areas such as market, raw materials, total investment – amount and technology of plant and equipment – location and the type of organisation i.e. private ownership, partnership, etc. will be in greater details. In other words, each of the areas will be examined in terms of all the relevant details. Secondly, the interrelationship between each of the areas will have to be fully worked out. An example should make this clear.

An engineer who would like to make one of the components of bicycle on a small scale obviously cannot meet the total demand for that component. His whole approach in examining this item will be governed by either a local dealer or meeting part of the demand by a cycle manufacturer. This would mean that from the two industrial products and two business opportunities he will first decide whether he selects industry or business. After doing this he will choose either a product or a business line as the case may be.

In these situations you will be required to work out the interrelationship between different areas. From the point of view of the entrepreneur, it is necessary to remember that each of the areas has to be evaluated (a) independently and (b) in relation to each other. This can be almost a continuous process wherein you would be moving from one area to the other and it will be a "back and forth" process. (See Exhibit 1.) It must be emphasised here that no area should remain without a detailed examination.

Exhibit-1
OPPORTUNITY IDENTIFICATION – AN INTERDEPENDENCE PROCESS



The most important areas will be demand and market, investment, plant and machinery and technology working capital, total investment, raw material availability — indigenous or imported — and the price, price-cost-volume relationship and the location of the project. It will be easy to understand that these areas are closely interrelated and cannot always be examined independently. To provide a reckoner we give below a check list in the form of a framework for Product/Service Selection.

Framework 1 for Product/Service Selection

Industrial/ Product/ /Business	Total Invest-ment	Market/ competit-ion	R.M./ Merchan-dise	Loca-tion	Others. Labour Utilities	Overall rating
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Nails/ Hinges etc.						
PVC moulded shoes						
Cold storage service						
Xeroxing Unit						

Clues on how to use the framework:

2) Put High, Medium or Low as per your financial strength
3) Competition could be stiff or moderate
4) Could be easily or not easily available
5) Could be favourable or unfavourable
6) Could be again favourable or unfavourable
7) Acceptable — Not acceptable

The overall assessment is thus an outcome of subjective and objective factors relevant to each product/service line. Finally you should emerge with your opportunity.

Activity 4

For any one of the products given in the framework (figure 3) complete the columns, by finding out relevant data, in respect of your own town/locality.

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What we have done so far is a step-by-step approach to opportunity sensing and selection. An important aspect of this approach should now be understood. When an idea is in the process of becoming an opportunity one tends to examine it broadly in terms of: **'whether this is a line for me or not'**. Alternatively, **'do I have all that the line would demand'**. In this process we examine a potential opportunity from the point of view of becoming **The Opportunity**. This is often termed as Project Formulation meaning thereby the process and steps through which an opportunity becomes a project in which the individual is willing to invest his time, money and other resources. The manner in which the individual would pass from the stage of sensing to identification and final selection is almost imperceptible. But the opportunity must be transformed into a business and project formulation is the most important stage in this.

An opportunity which does not result into a business or industry is not an opportunity for us. It is just a vague idea. The entrepreneurial process, to which we referred at the beginning of this unit, should be understood in terms of what happens in (a) identification of an opportunity and (b) setting up an enterprise based on the same. A small case can perhaps illustrate this.

Two friends Sudhir and Vikram were travelling from Ahmedabad to Bombay by a day train — a distance of 492 kms. On their way after Baroda their train stopped at a station Bharuch situated on the banks of the river Narmada. Young teenagers with packets of roasted peanuts crowded the compartment and almost every passenger purchased one packet. Sudhir and Vikram also did the same and started munching. "The peanuts are really good" tells Sudhir to Vikram — the latter nods. Both of them reached Bombay by afternoon and part company. While Sudhir went home Vikram took the next train to Bharuch. In Bharuch he contacted shopkeepers and those who roast peanuts. He finalised a business deal for them to send a pack of 25 kgs of roasted peanuts daily to Bombay. From the third day his business started. He was selling packets of roasted peanuts in Bombay.

You would have noticed that in the above case there is almost no time gap between (a) and (b). But the pertinent question for us is how did Vikram examine "selling roasted peanuts" as a business proposition? In other words, how did this idea make its headway into a business opportunity for Vikram? We list below the kind of questions that Vikram must have turned in his mind.

i) Who will buy this and who will be my principal buyers all through the year?
ii) In what packet size and at what price could I sell it in the Bombay market?
iii) How much will it cost me per kg. of roasted peanuts plus packaging and transport in Bombay?
iv) Given the quality and price of other substitutes to peanuts in Bombay will my price per packet be comparable to the cost at which I shall be receiving the same in Bombay from Bharuch?

To the above main questions a few supplementaries can be added but our objective in the above enumeration is again to lay bare the process, through which this random idea was turned into a business. When you are about to consider an opportunity as a possible business your mind begins to visualise what the business would be like when it is established. What kind of a shop/factory shed, what merchandise/raw material etc.and how will the business look like when it starts functioning. This ability to visualise or draw a mental picture is called **simulation.** This is a well-known technique of management. In other words, with regard to your opportunity you should be able to visualise the same as a **running enterprise.** You can do this better if you have the required experience and a keen sense of observation.

Mere simulation is not enough without a sound backing of calculations as to how much will it ost and how much will it earn. This requires abilities and skills from an altogether different field viz. costing and accounting. Since in a small enterprise almost every activity and decision is taken by the entrepreneur-owner-manager he ought to have these abilities and skills. Perhaps, you should now be in a position to understand how an opportunity is transformed into a business or industry.

To recapitulate, an opportunity which is likely to be accepted finally as The Opportunity is broken up, as it were, into components as follows. An opportunity has thus:

a) Demand and marketing component
b) Costing and pricing component
c) Financial component in terms of term-loan and working capital
d) Locational component — where are you located
e) Merchandise, raw material and processing, manufacturing component i.e. production component.

You have to visualise the opportunity as passing through the above to be able to say that this is The Opportunity. Such an examination should enable you to answer the following basic questions.

a) the product/service is needed i.e. it has a market;
b) that there is enough room in the market for a volume of production that you intend to produce; and
c) at that volume you will be producing it cheaply enough to earn some profit for

you. **Market** or **Need, Enough Volume** and **Cheaply Enough** are the three catch words for you.

In the case of a servicing unit, say a xeroxing centre, you should be able to translate the above in terms of the same three catchwords. This gives you a formula with which the opportunity is completely screened as a business venture, an opportunity is now a business. Another way of defining this is to say that a business opportunity implies a series of activities in which you will decide to invest your time, money and organising ability. In short it is an opportunity "worth investing in".

Opportunity Identification and Promotional Policy
Small enterprise, small scale industry and many other self-employment based activities form the principal objective of the industrial policy of the Government. Let us examine how are these policies and programmes helpful to an individual at the two stages of an enterprise viz. identification of an opportunity and setting up the same as a business or enterprise.

i) Identification of an opportunity	a) Reservation of 836 products for exclusive manufacture by SSI b) Government purchase programme for products of SSI c) Liberal financial assistance for term-loan and working capital d) Availability of infrastructure facilities like shed, water, power, roads etc.
ii) Setting up an enterprise	e) Facilities for acquiring machinery on hire-purchase basis, allocation of scarce raw materials etc. f) Marketing assistance.

It will be seen that taking all the promotional measures, various requirements of opportunity identification and project formulation are adequately covered. To these must be added entrepreneurship and self-employment development programmes with different target groups such as, unemployed youth, technicians, women, SC/ST group, rural youth etc. The promotional umbrella thus covers a wide range of areas but its main focus is opportunity identification by a young man to set up a small self-employment based unit of his own. For a detailed information based survey of promotional policies, measures and authorities engaged in the same, see Framework 2. (This part of our analysis will be understood fully if it is taken along with Unit 3 Institutional Interface.)

4.6 AN ATTEMPT AT INTEGRATION

It should be clear now that analysis of opportunity alone is not sufficient, nor is analysis of strength and weaknesses. Areas of promotional policies need to be integrated at every stage in the whole process of opportunity sensing and identification. To illustrate this we give below two ways of understanding the entire process. One, how a rugged experienced entrepreneur would go through this exercise and two, a diagrammatic representation of the same.

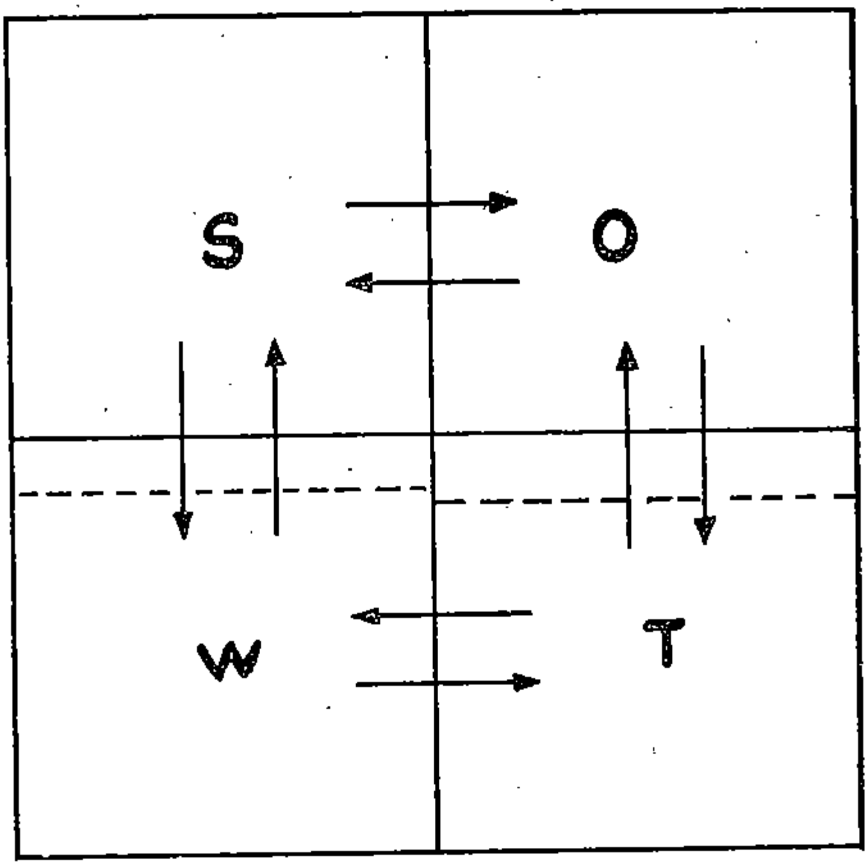
An experienced entrepreneur would evaluate an opportunity somewhat as follows:

1) How large is the gap between demand and supply in the market and what is the nature of competition in the market for this product.
2) Is the product covered under any of the promotional policies of the government so that either entry into business or competition in the market are facilitated.
3) Are there any special product/service specific problems that he will face and can he avail of any part of promotional policies to soften the impact of these problems.
4) Based on all such product-market-policy, policy-product-market type of analysis he will finally conclude that the opportunity is **worth-investing-in.**

The same process is represented diagrammatically wherein the SWOT framework is shown and its visualisation by an entrepreneur as not a static but manipulable framework

Framework 2

Opportunity Identification through SWOT



Notes: i) The four rectangles represent the subjective and objective side of an opportunity respectively.

ii) Dotted lines which enlarge S and O can be due to

a) policies which help new, first generation self-employed entrepreneurs and hence add to their strengths

b) policies of reservations of products etc. may enlarge the field of opportunities and contract that of threats.

iii) The SWOT framework can be a manipulable framework.

List of official measures and programmes of assistance to the small scale sector in India

Both the Central and State governments have been giving several incentives, assistance and concessions as part of promotional measures to achieve higher rate of industrial growth, dispersal of industry, development of economically backward areas and bringing into the mainstream a new class of entrepreneurs. An attempt is made in the following to place the totality of promotional measures in a conceptual framework with the names of the agencies providing the same.

The different promotional schemes of the State only seen from the major policy decisions of the Central government.

Focus	Objectives	Statutory Authority
A Promotion of New Enterprises		
1. Entrepreneurial development programmes	Self-employment programme	DIs
	Educated unemployed programme	DIs
	Half-a-million jobs programme	DIs
	Jawahar RojgarYojna etc	
2. Ancillary development	Higher capital ceilings, public sector schemes, scrutinising of licences, compulsory development of ancillaries	DIs

3.	Rural industries project programmes	Loans to artisans, supply of improved tools, liberalised credit	SIDO/DIs
4.	Backward area development programme	Concessional refinance capital subsidies, selection of growth centres, industrial potential surveys.	SIDO/DIs
5.	Lead bank scheme Intensive district campaigns	Banks' area development programmes Zero industry districs—target for promoting Tiny/SSI unit self-employment based industry-cum-business activities	Nationalised banks All agencies
B	**Provision of In-puts**		
1.	Plant and machinery	Hire purchase facility	NSIC/SSIDC SFC
2.	Raw materials	Quotas for scarce materials, Local supply depots for imports and strategic local materials	SSIDCs/DIs
		Canalising of imports	STC/MMTC
3.	Finance	Grants	DIs
		Loans for fixed assets	SFCs
		Loans for working capital	Banks
		Guarantee for loans	NSIC/SSIDC
		Credit guarantee scheme	RBI
		Refinance facility	IDBI
4.	Industrial estates	Subsidised rents	DIs
		Hire purchase facility	SSIDCs/
		Common service facilities	IIC
C	**Technical Assistance**		
1.	Industrial extension service	Common workshop facilities,Toolroom assistance, technical advice	
		Training (labour & Management)	SISIs
		Design assistance	
2.	Research and development	Prototype-cum-training centre	NSIC
		Product & Process development	DRDC/NRLS
		Knowhow development	
3.	Modernisation programme	Covers selected industries where modernisation is required	SIDO/ SISIs
4.	Appropriate technology cell	Experimental projects in product line to save foreign exchange or generate mass employment	Ministry of Industry
D	**Marketing Assistance**		
1.	Government	Reservation of 222 items for procurement from SSI, price preferences, registration scheme	NSIC/ DGS&D
2.	Export promotion	Procedural assistance	SIDO/TDA
		Marketing assistance	EPCs/DEP
3.	Import substitution	Import licencing, according priority to projects	SIDO/ CCI&E
4.	Quality marketing schemes	ISI standards, test laboratories	SISIs
5.	Subcontracting exchanges	Part of ancillary development Programmes	SIDO

4.7 SUMMARY

Identification and analysis of an opportunity represents first step towards establishing an enterprise. Opportunities manifest themselves in a number of ways; an effective technology, a cost effective method of doing an activity, a locational advantage or simply a distinctive competence to enumerate a few. This unit on opportunity scanning and identification discusses the process of OSI and the various frameworks used to analyse an opportunity. It also presents a list of measures and programme developed by the state to assist the small entrepreneur. A concise description of the type of assistance and the authority concerned, to help the entrepreneur locate the information, assistance relevant to his needs during opportunity definition and enterprise establishment.

4.8 SELF-ASSESSMENT QUESTIONS

1) What do you understand by OSI? What is the role of OSI in successful enterprise management?

2) What are the main techniques utilised for opportunity scanning and identification? Discuss with examples.

3) Using the framework 2 given in the unit, carry out an opportunity analysis for the following:
   a) a beauty saloon
   b) a fast food restuarant

4) How would you use SWOT analysis to identify opportunities for SSI/Self-employment. Discuss with examples.

4.9 FURTHER READINGS

Richard M. Hodgills, *Effective Small Business Management*, Academic Press Incorporated, Harcourt, Brace Jovanovich.

UNIT 5 MARKET ASSESSMENT FOR SSE

Objectives

After reading this unit you should be able to:

- familiarise yourself with the concept of marketing orientation
- appreciate the importance of the need for market assessment
- outline the aspects involved in market assessment
- understand some broad issues involved in the analysis of market demand, competitive situation, and trade practices.

Structure

5.1 INTRODUCTION

A firm is not an isolated economic unit. It must interact with the external environment. When there is a shortage of raw materials the production suffers, development of a substitute product affects the demand for the existing product, and entry of a new unit manufacturing the same product increases competition. The external environment also imposes certain restrictions or constraints on it which may be in the form of legal obligations or social responsibilities. Legal obligations are put through government rules and regulations. Social responsibilities refer to things like fair trade practices, welfare of the employees, and protection of the environment. Several opportunities and threats are provided by the external environment which must be taken cognisance of to be able to survive.

Interaction with the market, however, is most pervasive and intense. The only successful product, by definition, is one that sells. In order to sell a product, a firm has to deal with a large number of customers. It has to constantly interact with selling agents like distributors and retailers. It has to make sure that the product remains fine tuned to the needs of the market — the actual customers, to be precise. It has to sharpen its market focus so as to be perceived, and appreciated, as consistently delivering some '**advantage**' to its customers. It has to develop 'marketing orientation' in its outlook. All this requires a thorough and sound assessment of the market in which the owner of a small enterprise has to operate. Before we try to understand the process of market assessment, let us reflect upon what is meant by '**marketing orientation**' referred to above.

5.2 MARKETING ORIENTATION

Since companies have to operate in dynamic exogenous conditions, they adapt their business philosophies to what seems to be appropriate at the time. Marketing theory has altered accordingly. The early orientation in marketing was **production orientation.** This orientation was held at a time when there was general scarcity of manufactured goods in the market. Under this orientation, the major task in marketing was to make the product widely available to the consumers at an affordable price. Look at the following definition of marketing :

> The performance of those business activities that direct the flow of goods from producers to consumer or user.
>
> *(American Marketing Association,*1960)

The next phase was of **selling orientation.** Under this orientation, the emphasis shifted to undertaking an aggressive selling and promotion effort to sell what a firm produced. There was little research into what the customers wanted. All selling efforts were directed towards achieving the firm's objectives of profitability, sales growth, or return on capital employed. Customers were considered to be no more than the means of achieving these objectives. Consider, for example, the following definition of marketing :

> The performance of business activities that direct the flow of goods and services from producer to consumer in order to satisfy customers and accomplish the firm's objectives.
>
> (E.J. McCarthy, *Basic Marketing,* 1964)

As the industrial activity intensified, the competition increased, and the customers became more discerning. They were no more ready to buy what was offered to them. This change increased the need to improve product features, distribution, and to use advertising and personal selling. A new, more scientific approach, called **marketing orientation,** emerged. The approach relies on first finding out what the customers want and then creating and developing products or services that satisfy their wants. The effort is to create a product that satisfies the wants of the customers rather than to change their wants to suit the product. The main issue is not to produce something but to produce according to what is wanted by the customers. Selling focuses on the needs of the seller; marketing on the needs of the buyer. When this is clear, one would be able to offer a product that is saleable through usual marketing efforts. Fig 5.1. illustrates the difference between the selling and the marketing orientation.

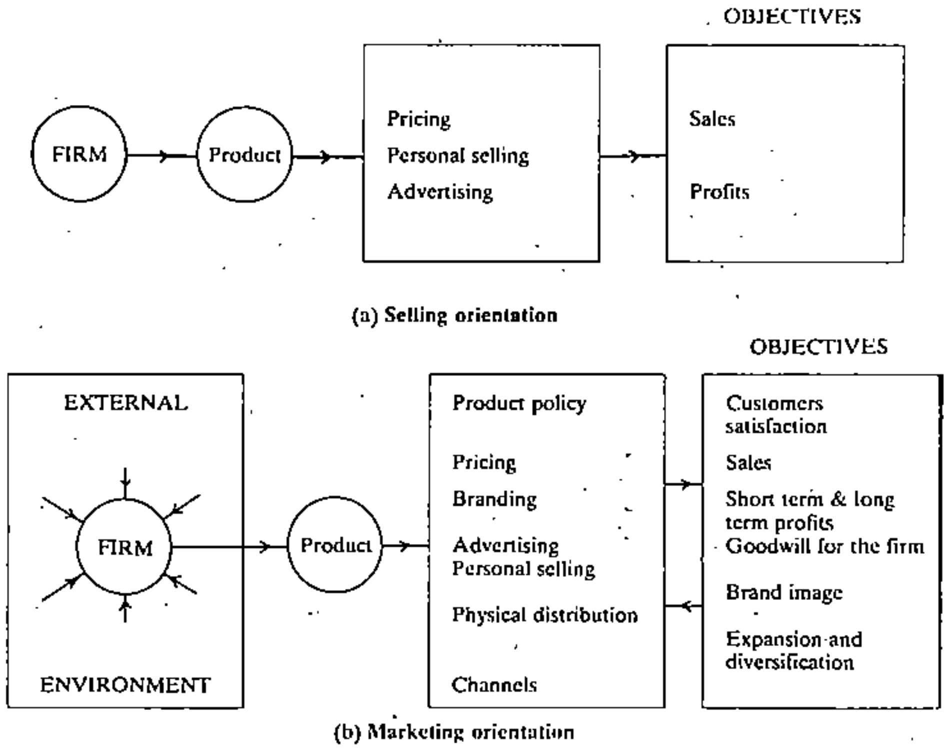


Fig 5.1: Difference between the selling and the marketing orientation

Under the marketing orientation, instead of being **'company centred'** the definitions of marketing moved their focus on **'exchange'** and 'value to the consumer'. Have a look at the following widely accepted definition of marketing:

> Marketing is a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and values with others.
>
> (Philip Kotler, *Marketing Management,* 1988)

Thus marketing lays emphasis on forming relationships with the customers, and on beneficial exchanges rather than one sided rip offs. In simple terms, at the conception stage itself of a new firm, the owner should think of the **'benefits'** his product will offer to the customers. The benefits may be tangible or intangible. Tangible benefits are those which can easily be measured, assessed, or compared. These may be in the form of better product quality, durability, lower price, easy availability, good after-sales service, instalment facility, or better packaging and presentation. Intangible benefits are those which are to be felt or perceived as a consequence to the use of a product or service. As an example, you may feel that the use of a particular product enhances your status in the society. Or, the use of a product may give you a feeling that you are being appreciated as a person with simple and sober tastes.

Activity 1

Try and spell out the tangible and intangible benefits that you look for while buying the following products or services:

	Tangible benefits	Intangible benefits
Toilet soap	....	....
	....	....
Wedding suit/saree	....	....
	....	....
Hair dressing	....	....
	....	....
[illegible]	....	....
	....	....

Whatever benefits that are offered should be of real value to the customers. It must be remembered that a product which lacks real appeal cannot be salvaged in the long run by any marketing inputs like heavy advertising. It is important, therefore, that the owner of a small firm finds out the wants of the customers and offers a product that is able to satisfy at least some of those wants. As shown in Fig.5.1, under the marketing approach, we achieve sales and profits through customer satisfaction. Many decisions at the time of launching of an enterprise like the scale of operations, the choice of technology, the level of product quality, and the price to be charged, will be influenced by the wants of the customers. When this kind of marketing orientation is present right from the beginning, one can be sure of the effectiveness of the marketing efforts.

The marketing orientation will force an entrepreneur to seek answers to many hard questions—relating to **product quality, price, market segments, technology of manufacture, marketing inputs etc. — before** setting up his venture. The exercise will enable him to move ahead with greater confidence and confront the problems that may arise during the later stages in a professional manner rather than getting caught unawares.

5.3 NEED FOR MARKET ASSESSMENT

To determine what the customers want is not an easy task. The market is composed of a large variety of customers who differ in their education, employment, income, status, preferences, likes and dislikes, and opinions. Some may be located nearer you in your town or state, and the others in distant states or even in other countries. Depending upon several factors like the resources available, the scale of operations, and the impact on profitability, one has to decide which customer groups, called target segments, are of particular interest to the firm. The identification of the target segments helps in making a rough estimate of the market demand for the product.

Once an estimate of the market demand for the product is made, one has to look for the competitive situation prevailing in the market. A firm cannot just pursue its own policies without regard to what the competitors are doing. Competition may be from other small firms or even from large, well established companies. The nature and extent of competition will put several constraints on the marketing policies of a firm.

For example, it may not be possible for it to charge a price that is higher than what the competition is charging, especially during the first one or two years. A detailed analysis of the competitive situation will also help in identifying the gaps and opportunities that may be available for exploitation.

One of the most disturbing thoughts that comes to an entrepreneur's mind during the conception and implementation stages of setting up a small enterprise is how he would reach the numerous prospective customers. They may be scattered in a wide geographical area. Many products are such that they require the help of marketing intermediaries — wholesalers, distributors, retailers etc. — to reach the ultimate consumers. Through their contacts, experience, and specialisation, these intermediaries make the product available and accessible to the target markets. Since intermediaries are independent organisations, they have thier own ways of doing business. Their expectations and requirements regarding price, discount, credit, promotional support, and mode of delivery of the product may vary quite considerably. However, these usually conform to the trade practices that are prevalent in the market. Understanding the prevailing trade practices, therefore, forms an essential part of market assessment exercise.

These three things — namely, analysis of the market demand, the competitive situation, and the trade practices — are important for sound market assessment. We shall now consider each one of them in some detail.

5.4 MARKET DEMAND ANALYSIS

One of the trickiest questions that haunts an entrepreneur is: Whether the product or service that he wishes to offer to the market will have sufficient demand or not? Proper demand analysis and forecasting helps in formulating effective marketing programmes. For example, the price to be charged for a product, the advertising budget to be allocated for its promotion, and the sales promotion tools to be employed, will all be based, at least to some extent, on the assessment of its demand. If a firm is able to make an accurate prediction about the level of demand for its products, many decisions pertaining to marketing, inventory control, purchasing, production, personnel, and finance become exceedingly simple.

The actual situation, however, is not so simple. The demand picture for most products and services is very complex and unstable. Even after much advancement in the field of marketing, demand forecasting remains a grey area. There are a large number of variables and assumptions involved in any exercise of demand estimation. Many factors that impinge upon the demand for a product are external to the firm and hence uncontrollable. These include behaviour of the customers and competitors, government policies, technological breakthroughs, and general economic conditions. Many assumptions are required to be made which may or may not come true. The process becomes more complex for products which are innovative and yet to be tried in the market.

Notwithstanding such complexities, potential investors will wish to see, and rightly so, some evidence that there is a reasonable prospect of marketing their project's output in a profitable manner. Rightly, because starting a new business is no time for self-deception and some hard questions asked in the beginning may save a lot of money and trouble later on. One must be able to provide satisfactory answers to questions like: **1) Who would buy the product? 2) Why would they buy it? and 3) How many would buy it?** The exercise of market demand analysis will provide some insights into these questions.

Market Demand

According to one definition, demand refers to the willingness and ability of consumers to buy products and services. Thus, when the consumers have **both** willingness and ability to buy a product, we say that there is demand for it. This is a very broad definition and if we consider all the potential customers who have the willingness and ability to buy a product we arrive at what is termed as its **'total market'** or its **'potential market'**.

A firm has its own area of operations and is normally concerned with the demand for the product in that particular area or market. We, therefore, narrow down our definition of demand by making certain qualifications and concentrate on what is termed as **'market demand'**. Consider the following definition given by Philip Kotler (1988):

> Market demand for a **product** is the **total volume** that would be **bought** by a defined **customer group** in a defined **geographical area** in a defined **time period** in a defined **marketing environment** under a defined **marketing programme.**

As clear from the definition, there are eight elements or variables which must be understood in order to determine market demand.

1) **Product:** The class of product has to be clearly defined. For example, a manufacturer of fans must decide whether its product is table fan, ceiling fan, pedestal fan, exhaust fan, cooler fan, industrial fan, or a combination thereof. Then there are various sizes and other features in each class. Opportunities available to the manufacturer differ according to the exact nature and specifications of the product.

2) **Total volume:** We have the question of how total volume is measured. It can be measured in terms of physical volume (i.e. in terms of units sold), in monetary terms, or both. It can also be measured in terms of per cent of total market, i.e., in relative terms. As an illustration, a demand analysis for shoes may reveal that in one particular region, the number of pairs of shoes sold is 1000, valued at Rs. 50,000. In another region, the number may be 750, valued at Rs. 150,000. It is evident that depending upon our requirement, the data on total volume must be in appropriate units.

3) **Bought:** The third element **'bought'** needs also to be understood. Do we have to assess the volume ordered or booked, despatched, paid for, received, or consumed? The figures may vary according to the basis used. In the case of foodgrains we normally refer to quantity consumed, and in the case of construction industry we refer to orders booked. The relevance of the correct understanding of the term 'bought' becomes clear when we look at the example of the scooter industry in India. Only a few years ago there was a huge order booking and a customer had to wait for several years before he could get the delivery. Many people had booked scooters in anticipation of the high premium that was prevailing in the market. As the supply position improved, the premium reduced considerably and many of them cancelled their bookings. Thus, the figure of order booking was portraying a distorted picture of the actual demand for scooters.

4) **Customer group:** Market demand for a product should be measured for the customer group that is of interest to the firm. Examples are a manufacturer of brief cases who estimates the volume to be bought by the high income group people, and an educational institution that estimates the demand for its courses from the already employed and the unemployed youth.

5) **Geographical area:** The geographical boundaries within which market demand is to be measured must be clear. This is particularly true for a small enterprise since its operations are usually confined to small areas. Service establishments also have to define their geographical boundaries while estimating market demand. A Yoga centre or health clinic enjoys considerable demand in a metropolitan city but the concept is yet to establish its utility and acceptance in smaller towns and rural areas.

6) **Time period:** Demand estimation must always be for specific time period — for the next season, for the coming year, for the Plan period, and so on. When the time frame is an year or so, we call it short range forecasting, and when it is in terms of several years ahead, long range forecasting. As we increase the time frame, the forecast becomes more tenuous as the environmental factors may change beyond our present imagination. Thus, for products like computers and fashion goods it is almost futile to make any long range forecasts.

7) **Marketing environment:** Market demand is influenced by many external environmental factors. These include general economic conditions, technological breakthroughs and developments, government policies, political changes, changes in consumer behaviour and competitive situation, and even natural phenomena like rainfall and weather conditions. A cold drink manufacturer has to make certain assumptions about the length and severity of summer period in the region of his

interest; a film maker about the tastes of his audience; a helmet manufacturer about the new legislations that may be put into force for the scooter drivers; a TV manufacturer about the technological developments that may take place in the field of electronics in general and reception and transmission of audio and video signals in particular; and so on.

8) **Marketing programme:** Finally, there are controllable factors which the firms use to influence the demand for their products. These may be termed as marketing efforts or marketing programmes of the sellers. These include pricing strategies, advertising, sales promotion, and personal selling. The marketing efforts proposed or assumed should be specified in order to determine market demand.

The definition of market demand, although lengthy and complex, gives us an idea of all the factors and conditions on which the demand for a product depends. **Company demand** can be derived from the market demand. It is the company's share of the market demand.

It must have been abundantly clear by now that market demand analysis is a complex exercise. Very few products or services lend them to easy forecasting. For an accurate and reliable forecast, many factors have to be considered and consequently the cost becomes prohibitive. Fortunately, a small entrepreneur does not need to go for high sophistication and can manage within modest costs. At the project planning stage his primary concern is whether there is enough demand for the product or service that he wishes to produce. An experienced entrepreneur has to make the following comments on the process of demand analysis:

> "If we are contemplating the manufacture of an item on a small scale, we should see that it has enough existing sales in the market we have chosen to cater to. If the total sales of the item in the chosen market is more than ten times our contemplated level of production, we do not have to worry too much about the demand for our product at the planning stage. Adding a small unit is not going to alter the production figure of the industry in a substantial manner, and, I am confident, with proper efforts and planning, one can snatch, over a period of two or three years, around ten per cent of the market share so as to achieve the targeted sales. In case the product is an innovative one, we should be satisfied if it has sales potential large enough to be tapped with the help of limited marketing inputs that we can afford to support."

Still, some efforts have to be made to arrive at the broad demand estimate. A firm can have both household as well as institutional demand for its product. The demand from the household customers is generally met through the dealers and, as such, a rough estimate of demand from such customers can be made by personally contacting the dealers selling the item. Similarly, contacting the relevant institutional customers should be able to give an idea of the demand from this quarter. Besides helping in the exercise of demand estimation, such contacts with the dealers or the institutional customers will help the entrepreneur in:

a) assessing the customers' requirements in terms of price and quality;
b) getting information on various aspects of buyer behaviour;
c) getting an idea of the nature and extent of competition, and strengths and weaknesses of the competitors; and
d) getting some knowledge of the prevailing trade practices.

Such personalised contacts can be gainfully made only when the customers are concentrated in particular areas. In case the customers are scattered in wide areas, published data regarding domestic production, installed capacity, exports and imports, raw materials availability, number of units producing the item, their geographical dispersion, and general health of the existing units may be of relavance in assessing the demand potential for a product at the firm's level. One has to find out the right sources of such data. One serious limitation of published data is that it is usually available after considerable time lag. The data should be analysed in light of the firm's typical requirements.

In some cases, it might be useful to conduct a sample survey; maybe, by sending a questionnaire through mail to a small but representative number of potential customers. It is advisable to take the help of an expert in the designing of the questionnaire, selecting the sample, and analysing the data for arriving at the demand figure. While designing a survey plan for a small enterprise, one must bear in mind the cost aspect and try to strike a reasonable balance between the cost and the refinement of demand estimate. A broad but reliable estimate of demand achieved through cost-effective and simple methods should be sufficient to serve the purpose.

Some institutional customers like Directorate General of Supplies & Disposal (DGS&D), and State Directorates of Industries enter into rate contracts with the manufacturing units for meeting the bulk requirements of government offices. To be able to enter into rate contract with these agencies, a firm must have enough financial resources, and production capacity to execute bulk orders that may be placed on it. It may be difficult for a new firm to capture this market in the initial stage and as such this point must be kept in mind while estimating the demand.

Activity 2

An entrepreneur who plans to manufacture shoes opines: "Since the population is ncreasing every year, the demand for shoes is bound to increase with time. I, herefore, don't see any problem for my firm from the demand side." What are your comments?

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5.5 ANALYSING COMPETITIVE SITUATION

'or any business, the understanding of the competitive situation is extremely mportant. In fact, it may be a matter of business life and death.

\ typical small enterprise may face competition from other small firms, and from ırge companies having established and well known brand names. The exercise of emand analysis would have already given the entrepreneur a fairly good idea of the ature and extent of competition prevailing in the market. He would have got a ough assessment of the market share being enjoyed by each competitor. However, ıe true nature and extent of competition can hardly be judged from the market hare being enjoyed by each competitor. In a vast country like India, the nature of ompetition may vary drastically from market to market. We have highly rice-sensitive markets as well as price-insensitive, quality-sensitive markets. It is, ıerefore, important for the entrepreneur to study the competitive situation with eference to the chosen market segments. In case of many products, the household nd the institutional markets may have altogether different types of competition. In rder to assess and understand the competitive situation, an entrepreneur should try) answer the following questions:

) How many firms are in competition with him?
) What are their market shares?
) What are the strengths and weaknesses of their products?
) What kind of consumer image does each product enjoy?
) What trade practices do the competitors employ?
) Who are the major customers of each brand?

. study of this kind can be systematised by using a chart shown in Fig. 5.2. The tercise of preparing the chart may be quite tedious but the help it will provide in ıderstanding the competitive situation would justify the work involved.

Competitive Products	Market share	Price	Product features	Product image	Discount to dealers	Credit terms	Major customers
BRAND 'A'							
BRAND 'B'							
BRAND 'C'							

Fig. 5.2: A framework for understanding the competition

This kind of rigorous analysis will bring to light where the entrepreneur can score over the competition, where the competition has an edge over him, and what are the areas of opportunities and threats. The analysis will help him tune his marketing efforts to the requirements of the customers and the trade. Correct understanding of the nature and extent of competition is essential as the whole process of marketing planning revolves around this understanding.

Activity 3

Take any product of your choice and try to fill up the chart shown in Fig. 5.2. Mention below what you think needs to be done to get the information that you do not possess?

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5.6 UNDERSTANDING TRADE PRACTICES

Once a product or service comes into existence, it has to reach the ultimate customers. An entrepreneur may either do it on his own, or take the help of middlemen, called intermediaries, like distributors and retailers. In case of many products, due to the nature of the product, the dispersion of the customers in large geographical areas, or their buying habits, it may not be feasible for a firm to reach the ultimate customers directly. For example, if it is almost customary for the customers to buy detergent powder from the retailers, it is neither easy nor fruitful to approach them directly through own salesmen or through mail. There are many products like woollen garments, plastic toys, crockery, stationery items, and utensils, which are sold only after the customer examines and evaluates the various options available to him. It, therefore, becomes almost a necessity to employ middlemen to sell such goods. Even those companies making high-value products like computers and machine tools are today taking the help of middlemen in order to expand their markets. The study of trade practices in this light becomes important.

There are many types of intermediaries like distributors, wholesalers, retailers, commission agents, brokers, super-bazars, and export houses. Each one of these performs particular functions for the manufacturer. The kinds of services they offer are different. Some invest money in stocks before selling them for a profit. Some just provide the service of consummating a sale for a nominal payment or charge. Depending upon the kind of service provided, each has its own terms and conditions of business.

An entrepreneur must try to understand the trade practices that are relevant to his product. If middlemen are to be employed, the chain of distribution, the selling load to be taken by each member, the discounts to be offered to them, and the general credit terms, have to be studied. It is important to know where the distributors and retailers are to be appointed and what are the available modes of transportation to reach them. The prevailing sales tax and other legal implications in selling to the middlemen situated in different locations should also be studied.

In many cases, it is seen that the price of the product, especially when it is manufactured by a new, small enterprise, is determined by what the middlemen are ready to pay. They also dictate other terms of business like the length of the credit period to be allowed to them. Bigger among the trade members may even ask for their own brand name to be put on the product. A study of the trade practices in the beginning will provide some insight into how the product shall ultimately reach its customers, what are the costs involved, what infrastructural facilities are to be provided for, what kind of product features the trade members are looking for, and at what price they are willing to buy it. A realistic assessment of this kind will help in ultimately bringing out a product that is saleable through normal marketing efforts, and in formulating policies that are in tune with the market requirements.

5.7 SUMMARY

A small enterprise has to constantly interact with the external environment, especially the market in which it has to operate. Its marketing efforts must stay fine tuned to suit the requirements of the market in general, and the needs and wants of the customers in particular. To be successful, it has to develop **marketing orientation** in its outlook. At the planning stage itself, the owner must think of the **benefits** — both tangible and intangible — that his product will offer to the customers.

In order to understand the external environment pertaining to the market, and to determine the needs and wants of the customers, an entrepreneur needs to undertake the exercise of market assessment. This exercise will provide answers to many questions such as: Who is likely to buy my product or service? Why would they buy it? How many would buy it? What kind of competitors do I have? What are their strengths and weaknesses? and What are the trade practices in respect of my product?

Three aspects need to be delved into in order to complete the exercise: 1) Market demand analysis, 2) Analysing competitive situation, and 3) Understanding trade practices. Once this exercise is completed, the owner would be able to move ahead with much greater confidence and sagacity.

5.8 KEY WORDS

Marketing orientation: A marketing approach that relies on first finding out what the customers want and then creating and developing products or services that satisfy their wants.

Target segment: A fairly homogeneous group of customers (market segment) to whom a company wishes to target its marketing efforts.

Demand: The willingness and ability of the consumers to buy a product.

Market demand: Market demand for a product is the total volume that would be bought by a defined customer group in a defined geographical area in a defined time period in a defined marketing environment under a defined marketing programme.

Company demand: It is the company's share of market demand.

Sample survey: A marketing research method in which a representative sample is drawn out of the population and a survey is then carried out to obtain the relevant information.

Intermediaries: Marketing middlemen — like wholesalers, retailers, commission agents — who perform a variety of functions in reaching a product from the producer to the final consumer.

5.9 SELF-ASSESSMENT QUESTIONS

1) What are the implications of 'marketing orientation' on the process of product selection?

2) Think of the 'benefits' that an entrepreneur trying to establish a typing school can offer to its customers.

3) Analyse the competitive situation with respect to the scooter market in India. Does it face any competition from the moped and the motorcycle markets?

4) What kinds of intermediaries are involved in selling a) pressure cookers, b) cigarettes, and c) life insurance?

5.10 FURTHER READINGS

Foster, Douglas (1982). *Mastering Marketing*, The Macmillan Press Ltd.

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UNIT 6 CHOICE OF TECHNOLOGY AND SELECTION OF SITE

Objectives

Upon completion of this unit, you should be able to:

- explain why product or service design is important to any organisation
- discuss various stages involved in product design
- identify major aspects that determine process
- identify and discuss some of the criteria used to evaluate process
- explain why location decisions are important
- identify and discuss the general factors involved in determining the location of a business
- use the techniques presented to solve typical problems

Structure

6.1 INTRODUCTION

Man has been striving to convert the scientific discoveries to application of human needs through invention, development, and innovation. The results of the efforts will be products and services to satisfy human needs. The backbone of any small business is the products or services it offers. The decisions related to product and service design will significantly affect the future of a small business organisation. The most effective way to approach a small business is either by creating an unique product or service that would be in great demand or to adopt something that is currently on the market.

Product and process go together and are critical elements of a small business operating strategy. The environment in which small business prevails is dynamic and pressures for change in product or service design can come from within the firm, competitors, suppliers, legal sources and legislations. A manufacturer is liable for any injuries or damages caused by a faulty product either because of poor workmanship or design. This aspect, known as product liability, provided under Consumer Protection Act, 1986 is a strong incentive for design improvements. The relationship between the product selected and the organisation structure can best be seen by considering the technology by which the product is produced. For new organisations the choice of product essentially determines the technology of production.

Processes can be defined as the facilities, skills and technologies used to produce a product or service. Technology selection will significantly affect the management of human resources, plant and materials capacity of the operation system. It also affects the external environment like markets, competitors and society. The technology chosen to produce should be flexible to take care of the changes in design of product or service.

Decisions relating to location are dynamic in nature and are important to new organisations. An ideal plant location is one where the unit cost of production and physical distribution is minimum and revenues are maximum. It should also provide an opportunity for the organisation to grow. It is important to avoid a troublesome location rather than finding an ideal site.

6.2 PRODUCT/SERVICE DESIGN

Decisions relating to the final product/service design will influence or determine the firms image, profitability, opportunity and as well as the problems it may face in the future. Product design specifications paves way for the Manager to take a decision regarding process selection, quantity, quality, and type of materials, the required labour skills and supervision to manufacture the product.

The first step in evolution of an effective operational system is the design of the product or service that is to be offered. The path from conception of an idea to a finished product depends upon the firm, the product and numerous other factors. Figure 6.1 shows detailed stages involved in product design. The concepts of standardisation, reliability, product simplification, modular design, reproducibility, maintainability, consumer quality level, value analysis are important considerations in evaluating designs in order to prevent unnecessary investment in equipment, labour, materials and overhead costs.

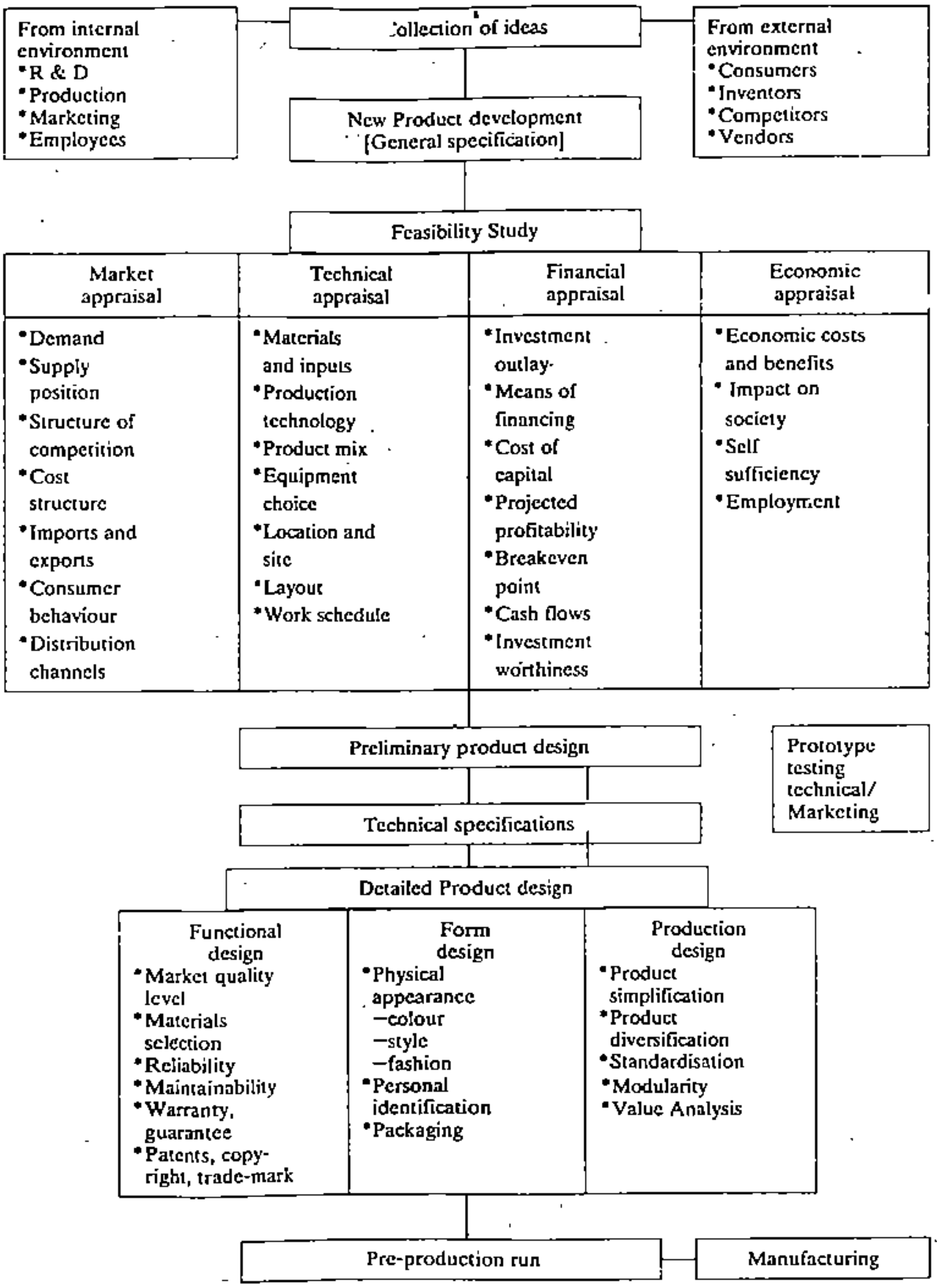

Figure 6.1: Stages in product design

Service systems like entertainment centres, health centres, hotels, public transportation, retail establishments, educational institutes, personal services, financial services etc., have acquired a greater importance in todays business world. The concept of designing the services is more difficult than product designing. Service organisations will concentrate more on lines of services offered, level of service and service availability in designing services.

Service organisations deliver their services mainly through the human resources of the productive system. The technology of transformation should be flexible enough to allow variation in needs of the customers. Since human resources are flexible and trainable, they can at tune to almost any service requirements which the environment needs. While designing the services, care is taken regarding methods of delivering the service rather than engineering specifications and productive process technologies. In fact it will be difficult to specify the service prior to the start of service. Market acceptability of intangible services are determined through surveys rather than through testing and demonstration. Services must be specified in a way to assure their conformity to the intended function, right timing, optimum cost and right quantity.

Activity 1

Select two service organisations and two product organisations from the SSI sector, study them to find out:

a) What were the considerations used in designing the product/service?
b) How do considerations for designing services vary from designing those for product?

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6.3 TECHNOLOGY DETERMINATION

Process decisions commence with product analysis that extends to every subassembly, raw material or component comprising the final product. Before taking up the process selection issue, the fundamental question to be considered is whether to make or buy the product. New and small enterprises concentrate on increasing the turnover through the buying process. Make or buy is a strategic decision and must be made periodically on each material or component required by the finished product. Some of the factors influencing make or buy decision are:

1) Idle facilities
2) Plant capabilities (Product quality, quantity and service, Personnel, equipment, future capabilities)
3) Economic advantage
4) Suppliers reliability (Quality, quantity, service, schedule)
5) Trade relations
6) Employment stabilisations
7) Trade union views
8) Alternative resource uses
9) Legal restrictions (Patents)

Make or buy analysis provides the planners with the comparison whether to produce or buy. After arriving at the decision of making the product ourselves the process determination phase can begin. The major aspects that determine process are technological and sequential. Technology can be defined as a combination of labour, machines, processes, energy and other inputs directly involved in the transformation of materials into products. Technology has increased the outputs of industrial and non-industrial sectors. It has improved the quality and reliability of the products, and saved the capital costs. Technology has not only been a primary source of improving productivity but also created new resources. Technological considerations occur at two levels.

1) General technological feasibility.
2) Specific choice of equipment.

General technology feasibility may be thought of decision regarding the theoretical feasibility of the making the product (Major technological choice), the general nature of the processing system (Minor technological choice), the specific equipment to be employed (specific component choice).

Sequential considerations are those that aim at determining the most efficient relationships between processing steps. Firms using existing technology should maintain a continuing interest in improving it as long as changes are economically desirable and can be justified. Increasing the output rate, reducing unit costs and improving the yield are the motives for seeking improvements in existing technologies.

Service organisations must decide how wide and deep their lines of service shall be. In many situations, firms depend on the financial resources to provide a wide range of lines. To arrive at the level of service the organisation has to trade off between its ability to supply the services against the need to operate economically at the same time. The managers need to plan how long the service will be available in a day and week. It is also essential to locate the service ideally to provide better service to the customers.

Various criteria for evaluating production process and equipment selection are

1) Product/service requirements
2) Technological feasibility
3) Financial considerations
4) Labour and skill requirements
5) Output and capacity needs
6) Compatibility with existing facilities
7) Flexibility
8) Raw material requirements
9) Size and weight limits imposed by plant or building
10) Maintainability
11) Spare parts inventory requirements.

The selection of the most desirable technology can be aided by tools like economic analysis, capital investment analysis, linear programming, marginal analysis, breakeven analysis, and incremental analysis. Motion and time study, work standards, and work measurement are the aids for integrating the human factors in process equation. For further reading you can refer Work and Job Design (Blocks 2 and 3) of MS-5 Management of machines and materials.

The sources of process knowhow for small manufacturing units are as follows:

1) National Research and Development Corporation, Council of Scientific and Industrial Research.
2) Private research laboratories recognised by CSIR like Shri Ram Research Institute, New Delhi, Gharda Research Centre, Bombay or Shroff Technical Services, Bombay.
3) Individuals who have experience in similar lines.
4) From turnkey suppliers of plant and machinery.
5) Foreign Technology.

Following is a list of institutions equipped with the facilities of pilot plant, prototype product manufacturing facilities, testing of product, R and D of new products:

1) Industrial Research Laboratories set up by different State Governments.
2) Central Institute for Plastics Engineering and Training Madras/Ahmedabad.
3) Prototype Training Centres of Small Industries Service Institute located at different places in our country.

Activity 2

Contact five entrepreneurs in your town and study them to gather the following information:

a) What were the criteria used while selecting the technology in use?
b) What were their sources of information regarding the technology?

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6.4 SELECTION OF SITE

Any new organisation has to take the major strategic decision on locating its facilities. The general objective in selecting a site is to minimise total cost of production and distribution. The selected site should also maximise revenue and provide an opportunity for further growth and expansion. Regardless of the type of business, there are some general factors that will influence locating an operation. The most important factors may be:

1) Personal factors.
2) Economics (Purchasing power of community, number of people employed in the area, per capita retail sales etc.).
3) Competition.
4) Geographic considerations.
5) Local laws and regulations.

Small business can avail benefits provided by the government through its policies on licensing, locating public sectors, subsidies, financial concessions, taxes, duties, and establishing industrial estates.

General procedure for making location decisions

Selecting a facility location usually involves a sequence of decisions. The general procedure proposed by William J Stevenson for making location decisions consists of the following steps.

1) Determine the criteria that will be used to evaluate location alternatives, such as increased revenues or community service.
2) Identify factors that are important, such as location of markets or materials.
3) Develop location alternatives.
   i) Identify the general region for a location.
   ii) Identify a small number of community site alternatives.
4) Evaluate the alternatives and make a selection.

A summary of the factors that affect location is provided in Table No. 1.

Table 1: Factors Affecting Location Decisions

Level	Factors	Considerations
Region/ Country	Locations of raw materials or supplies	Proximity, modes and costs of transportation, quantity available
	Location of Markets	Proximity, distribution costs, target market. Trade practices/restrictions
	Labour	Availability [general and for specific skills], age distribution of work force, attitudes toward work, union or nonunion, productivity, wage scales, unemployment compensation laws
Community	Facilities	Schools, churches, shopping, housing, transportation, entertainment, etc.
	Services	Medical, fire and police
	Attitudes	Pro/con
	Taxes	State/local, direct and indirect
	Environmental regulations	State/local
	Utilities	Cost and availability
	Development support	Bond issues, tax abatement, low-cost loans, grants
Site	Land	Cost, degree of development required, soil characteristics, room for expansion, drainage, parking
	Transportation	Type [access roads, rail spurs, air freight]
	Environmental/legal	Zoning restrictions

Source: Production and Operations Management by William J. Stevenson, Richard D. Irwin, Inc. Illinois, 1982

To make a thorough evaluation of pertinent factors involved in plant location it would be convenient to classify locational problems as follows.

1) Single facility location

Many locational problems like location of a manufacturing unit, a warehouse etc. which may fall under single facility location require the selection of a site. An important assumption made here is that revenue, costs and other facility characteristics of the firm do not depend on the location of other facilities of the firm or competitors. Single facility location situation can be evaluated by qualitative factor rating and locational break-even analysis.

Procedure for qualitative factor rating

1) Identify and evolve a list of relevant factors.
2) Allot a weight to each factor to indicate its relative importance [weights may total 1.00] among the factors considered to take a decision.
3) Establish a common numerical preference rating scale [0-100 points] to all factors.
4) Score each potential location based on comparison with other potential locations.
5) Multiply the preference rating by the weights and obtain resultant weighted score.
6) Sum up the weighted scores for each location.
7) The location with the maximum points is desirable.

Example 1

Tamil Nadu Glass Company is evaluating three locations for a new plant and has weighted the relevant factors as shown in Table 2. Scores have been assigned with higher values indicative of preferred conditions. Using these scores, develop a qualitative factor comparison for the three locations.

Table 2

		Trichy		Madurai		Coimbatore	
		Score	Weighted score	Score	Weighted score	Score	Weighted score
Relevant factor	Assigned weight						
Production cost	0.35	55	19.25	40	14.00	35	12.25
Raw Material supply	0.20	75	15.00	80	16.00	74	14.80
Labour availability	0.15	55	8.25	72	10.80	60	9.00
Cost of living	0.10	82	8.20	70	7.00	50	5.00
Environment	0.02	65	1.30	60	1.20	70	1.4
Markets	0.18	80	14.40	90	16.20	85	15.30
Total Location Score			66.40		65.20		57.75

Weighted scores are computed by multiplying the score times the assigned weight[for example, 55×0.35=19.25]. Weighted scores for each location are summed up to obtain total location score. Based on this data, Trichy is preferred location.

Procedure for locational break-even analysis

1) Determine all relevant costs that are associated with the locations.
2) Classify the costs for each location into annual fixed costs [F C] and per unit variable costs [V C]
3) Plot the costs associated with each location on a single chart of annual costs on Y axis versus annual volume of X axis.
4) Choose the location with the lowest total [T C] at the expected production volume [V]

Example 2

Potential locations at Trichy, Madurai, and Coimbatore have cost structures shown in Table 3 for a product expected to sell for Rs. 150/-.

a) Find the most economical location for an expected volume of 7,000 units per year.

b) What is the expected profit if the site selected in [a] is used?

c) For what output range is each location best?

Table 3

Potential location	Fixed cost per year	Variable cost per unit
Trichy	Rs. 1,50,000/-	Rs. 75/-
Madurai	Rs. 2,00,000/-	Rs. 50/-
Coimbatore	Rs. 4,00,000/-	Rs. 25/-

a) For each set, equate total costs to the sum of fixed costs and variable costs.

TC=FC+VC [V]

Trichy : TC = Rs. 1,50,000 + Rs. 75 [7,000] = Rs. 6,75,000.

Madurai : TC = Rs. 2,00,000 + Rs. 50 [7,000] = Rs. 5,50,000.

Coimbatore : TC = Rs. 4,00,000 + Rs. 25 [7,000] = Rs. 5,75,000.

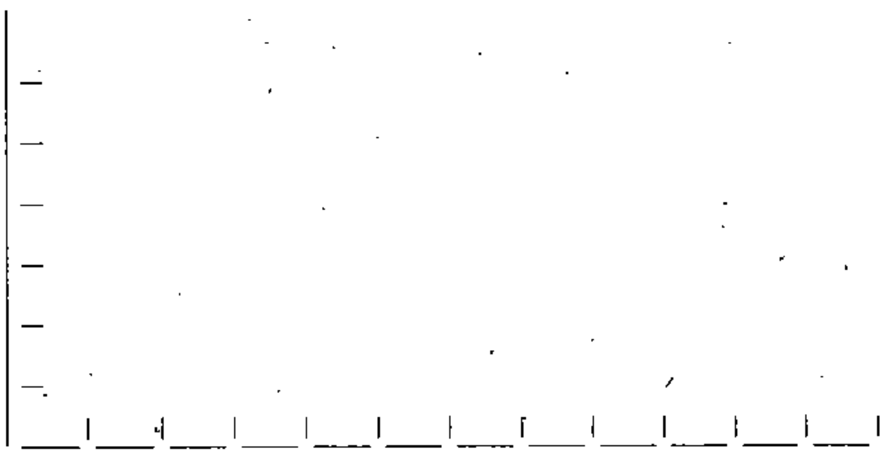
Total costs for Madurai is least hence the most economical location for an expected volume of 7,000 units per year.

b) Expected profits [Choosing Madurai] =
Rs. 150×7000 − 5,50,000 = Rs. 5,00,000/year.

c) Plotting for each location the total costs on Y axis and volumes on X axis, we have

i) Total cost curves of Trichy and Madurai intersecting at 2000 units, and Rs. 3,00,000.

ii) Total Cost curves of Madurai and Coimbatore intersecting at 8000 units and Rs. 6,00,000.



Hence for volumes
upto 2000 units Trichy will be preferable,
between 2000 units and 8000 units Madurai will be preferable,
for 8000 units or more Coimbatore will be preferable.

Activity 3

With respect to enterprises studied for Activity 3, study the criteria used for selection of site. To any one of the enterprises, apply the break-even analysis to determine whether the location decision was justified on this basis.

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2) The multi facility location

In the case of single facility location problem we have been concerned to select the minimum cost location, whereas in a multi facility location problem we must select the location which when added to existing locations, minimises the cost of the entire system.

Location of multiple factories and warehouses

In this type of location problem, total distribution costs and perhaps total production costs will be affected by the location decision. This problem is usually formulated by considering a production distribution network of plants and warehouses with criterion of minimising a transportation cost, subject to satisfying overall supply and demand requirements. The transportation linear programming [L P] method may be useful. For further reading the reader can refer Chapter 6 "Location and Distribution" of Modern production/operations management, Elwood S. Buffa, Wiley Eastern Limited, 1983.

3) Location of competitive retail stores

Many retail location problems can be formulated with the criterion of maximising revenue. These problems typically occur for retail stores, departmental stores and restaurants, where the revenue of a particular site depends on the intensity of competition from other competitor's locations nearby. Most retail location models are based on the assumption that revenue is proportional to the size of the facility and inversely proportional to the time the customer has to travel to the facility. The basic statement of the retailing model developed by D.L. Huff is $E_{ij}=P_{ij}C_i$

where

E_{ij} = expected number of customers at i likely to travel to shopping center j.

C_i = number of customers at i.

P_{ij} = probability of a customer at point of origin i travelling to shopping center j. P_{ij} is a function of the size of shopping center j, the travel time for a customer at point of origin i to travel to shopping center j, and the effect of travel time on various types of trips.

4) Emergency—Service location

A significant class of location problems concerns the delivery of emergency services like fire, police, and ambulance. These problems often have minimum response time as a decision criterion, since time is of the essence in delivering emergency service. These problems illustrate location decisions where a measure of service, such as response time, is the most important location criterion. Emergency response time can be estimated for different location sites by using simulation models. These models permit the incorporation of factors such as density of calls, speed of travel, despatching rules, and number of vehicles available. For further reading the reader can refer Chapter 6 **"Location and Distribution"** of Modern production/operations management, Elwood S Buffa, Wiley Eastern Limited, 1983.

Activity 4

Study the location criteria applied for the establishment of

a) A retail store
b) An emergency service outlet

How do these criteria vary and why?

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6.5 SUMMARY

Product of service design and process selection form an important part of operations strategy. Decisions on what to produce and how to produce are central to all other elements of operations strategy. Ever changing nature of environment subjects product and service design to continual changes for improvements. Product improvements come from internal and external sources. Product feasibility is carefully assessed before a product is designed. The primary concerns in product design relate to standardisation, reliability, simplification, reproducibility, maintainability, and modular design. Process determination consists of evaluating a series of decisions on the alternative ways of producing a product/service, the type of technology to adopt, the plant and machinery to be employed, the work flow system for the product/service and the method of performing the job.

The location of a facility involve far-reaching decisions which affect a new enterprise. Many factors like location of raw materials and sources of supply, labour supply, market considerations, community related factors, site related factors, and climate influence location of a facility. On a long-term basis these factors exhibit a potential impact. A common approach to take a decision on locating a facility is to classify the location problem as single facility, multiple facility, retail stores, emergency service and apply appropriate tools and superimpose the solutions with behavioural aspects to arrive at a solution which may not be an optimal but an ideal one with minimum problems.

6.6 KEY WORDS

Capacity: The amount of output that can be realised under a specific set of conditions, circumstances, and time. It generally refers to an upper limit on the rate of output.

Design: A detailed plan for a product or service that may include drawings, sketches, and measurements.

Effectiveness: The actual accomplishment of multiple objectives with a possible prioritisation within objectives. **"Doing right things"**.

Efficiency: Producing the desired output of goods and services with a minimum of effort, expense, waste, resources, and time. It is measured in total by dividing output by input. **"Doing things right"**.

Maintainability: It refers to the ability of a product or system to stay in operating condition with a reasonable amount of effort.

Modular design: It allows manager a variety of final product models with only a few basic components. Modules are common components grouped into interchangeable subassemblies.

Planning: The managerial function of projecting appropriate action well on time about a predetermined objective together with the means needed to achieve that objective.

Process: The sequence of steps or the system used to convert inputs of labour, materials, and machines into outputs of semifinished or finished parts, components, or products.

Productivity: A measure of the relationship between the output of goods or services and the resources required for their production. **"Efficiency of production"**

Products: Tangible outputs resulting from combining materials, labour, capital, and managerial skills.

Prototype: A model of a product or part of a product; first embodiment of features of a product to be used for testing.

Quality: Is a measure of how closely a good or a service conforms to specific standards.

Reliability: It refers to the ability of a product, part or system to perform its designed function satisfactorily for a specified period of time under a given set of conditions.

Reproducibility: It refers to the ability of the productive system to produce products of desired quality consistently.

Research: The deliberate and planned effort to seek anything new such as new relationships or new applications.

Research and development: Research with subsequent efforts to more cleary define uses and applications.

Services: Activities performed to provide people with benefits such as transportation or health care.

Simplification: It refers to reducing unnecessary variety in product line by decreasing the number and variety of products produced.

Simulation: Is a means of modelling the essence of an activity or system so that experiments can be conducted to evaluate the systems behaviour or response over time.

Specification: Is a detailed description in form of measurements, quantities, or qualities, required of a product or service if it is to meet the design requirements for function and aesthetics.

Standardisation: It refers to the attempt to gain uniformity in characteristics of a product such as size, shape, colour, quantity, and performance.

Strategic: In application to goals and strategies, the identification of those most important to a firm's long run survival and prosperity.

Strategy: The plan of activities identified as being necessary to achieve a specific goal or objectives.

Technology: Is the systematic process of using scientific, material and human resources to produce goods and services for human purposes.

Transformation: The act or means for converting inputs of one form into outputs of another.

Technological feasibility: When a process or machine is inherently capable of performing the necessary transformation requirements set forth in the design specifications.

Value analysis: The use of comparative cost and function figures in making purchasing and design decisions. It aims at ensuing that every element of cost contributes proportionately to the function of the product.

6.7 SELF-ASSESSMENT QUESTIONS

1) What are the basic steps in system of bringing a product/service from an idea to a finished product/service?

2) How does production design relate to technology determination and equipment selection?

3) The swastik company is considering to start a manufacturing plant in either Madras, Coimbatore, or Madurai. The company has collected the economic and non economic data shown below.

Factor	Madras	Coimbatore	Madurai
Transportation Cost/week	Rs. 860	Rs. 660	Rs. 490
Labour costs per week	Rs. 1100	Rs. 1080	Rs. 1260
Selected criteria scores			
(based on a scale of 0-100 points)			
Raw material	45	85	75
Housing facilities	55	35	40
Maintenance facilities	60	80	75

Company has pre-established weights for various factors, ranging from 0 to 1.0. They include a standard of .2 for each Rs. 10 per week of economic advantage. Other weights that are applicable are .35 on raw material, .15 on housing facilities, and .3 on maintenance facilities. Develop a qualitative factor comparison for the three locations?

4) Describe briefly how transportation linear programming can be used to help analyse location problems?

5) Describe how an entrepreneur may simultaneously consider both quantitative and qualitative factors in facility location analysis?

6.8 FURTHER READINGS

Effective Small Business Management—Richard M. Hodgetts, Donald F. Kuratko, Academic Press College Division, 1986.

Modern Production/Operations Management—Elwood S. Buffa, Wiley Eastern Limited, 1983.

Production and Operations Management, A Problem Solving and Decision Making Approach—Norman Gaither, The Drysden Press International, 1987.

Production and Operations Management—S.N. Chary, Tata McGraw- Hill Publishing Company Limited, New Delhi, 1988.

Utter Pradesh
Rajarshi Tandon Open University

MBA-3.2

Management of New and Small Enterprise

Block

3

SMALL SCALE ENTERPRISE — GETTING ORGANISED

BLOCK 3 SMALL SCALE ENTERPRISE— GETTING ORGANISED

Once you have made an assessment of the market and have identified the criteria you would use for finalising your site and location, it is time to draw up your business plan so that you have a clear idea of how would you utilise your resources to achieve the goals you have set for yourself. It is also time for you to decide upon the form of ownership that you would like to adopt because this has important implications for profit sharing and internal management of the enterprise.

You also need to decide about your sources of long-term and short-term finance, depending upon the projections that you have made in your business plan. This block discusses preparation of the project report, arrangement of the financing requirements and selection of the proper form of ownership.

UNIT 7 FINANCING THE NEW/SMALL ENTERPRISES

Objectives

After going through this unit you should be able to

- develop a framework for assessing your financing requirement
- describe the institutions which provide financial assistance to SSE
- explain in detail the various types of loans that may be availed from these institutions as well as the attendant requirement
- elaborate upon the defined role of the various financing institutions in respect of SSEs.

Structure

7.1 INTRODUCTION

Finance is one of the essential requirements of any enterprise. Small entrepreneurs, before setting up their organisation, need to be very clear about the extent and value of their financing requirements as well as the possible alternative sources from which these finances may be availed of while they would need to put in capital of their own. The Government of India as part of its policy of promotion of the small scale sector has set up a number of institutions to meet the financing requirements of this sector. Let us in this unit try to understand the type of financing needs that entrepreneurs may have and the institutional provisions to meet these requirements.

7.2 FINANCIAL PLANNING — ASSESSING THE FINANCING REQUIREMENTS

Financial Planning is appraisal of the financial aspects likely to happen in the future for which decision on course of action has to be taken now. Financial planning deals with futurity of present decisions in terms of goal setting. It helps developing strategies to achieve them by chalking out strategies, operational programme and assures smooth work. Goal-setting may be in terms of profits, sales, market share, acquisition of assets etc. Such goals are set after considering various functional areas like production, marketing, personnel, inventory, etc.

The goals that are set could be short-term and long-term. For example, determining capital structure of the firm shall be a long-term goal. The second step shall involve forecasting or determining the most probable course of events. A financial forecast includes estimation of the following :

1. Capital requirements
2. Working Capital requirements
3. Capital structure (debt-equity ratio)
4. Credit Policy
5. Contingencies

Financial planning is concerned with the general business policies as also trends in business and their impact on the financial position as well as condition of the enterprise.

also started giving assistance to small enterprises. After nationalisation of the major Indian commercial banks as also recognition of small scale enterprises as one of the priority sectors of material economy, performance of the banking sectors in this regard has been progressively improving.

Government of India having recognised the importance of small scale industries in the overall industrial development as also overall economic development of the country, has been engaged in formulating suitable policies and active programmes from time to time with a view to assisting small scale units in meeting their credit requirements. Since the second Five Year Plan (1956-61) several institutions have been created to provide financial assistance to small scale units on terms and conditions which are relatively more liberal than those applicable to large scale industrial enterprises. There are, at present, various institutions/agencies which are engaged in the implementation of several schemes for the promotion and development of villages and small scale industries in the country. Financial institutions rendering assistance to the small scale enterprises are given in the following

Activity 2

A) Talk to some small entrepreneurs who have availed of bank credit. Discuss with them to find out:

   a) What were the procedures followed to avail the credit?

   b) What were the problems faced by them in getting the credit?

B) Talk to the Bankers of these entrepreneurs to gather information on problem that the bankers face with respect to financing in this sector.

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7.4 FINANCIAL INSTITUTIONS WHICH PROVIDE ASSISTANCE TO SMALL ENTERPRISES

Financial Institutions rendering promotional assistance and credit facilities assistance to small scale industrial units/enterprises.

a) **Reserve Bank of India** : lays down the policies of lending supervision and follow up of advances to small scale industrial units which is recognised as priority sector.

b) **All India Lending Institutions**

   I. Industrial Development Bank of India (IDBI)—Small Industries Development Bank of India (SIDBI)—Various Schemes of the IDBI/SIDBI :

      i) Refinance Schemes for industrial loans
      ii) Special schemes for assistance to artisans and village and cottage industries, scheduled tribes/scheduled caste entrepreneurs, physically handicapped entrepreneurs, small scale industrial units
      iii) Refinance scheme for rehabilitation of small enterprises
      iv) Refinance scheme for modernisation of small industries
      v) Seed capital scheme

vi) Bills rediscounting scheme
vii) Assistance through National Small Industries Corporation
viii) Scheme to assist women entrepreneurs etc.

2. Industrial Finance Corporation of India (IFCI)
3. Industrial Credit and Investment Corporation of India (ICICI)
4. Industrial Reconstruction Bank of India (IRBI)
5. Export Import Bank of India (EXIM Bank)
6. National Bank for Agriculture & Rural Development (NABARD)
7. National Cooperative Development Corporation (NCDC)

c) **Other Financial Institutions**

i) Commercial Banks
ii) State Financial Corporations (SFCs)
iii) Export Credit Guarantee Corporation (ECGC)
iv) Deposit Insurance and Credit Guarantee Corporation (DICGC)
v) Regional Rural Bank and Cooperative Banks

d) **Others**

i) National Small Industries Corporation
ii) State Small Industries Corporation

Activity 3

Contact any one of the institutions described above, find out its financing service in relation to the small enterprises. Do you feel that there is still some gap between the financing needs of enterprises and the provision made by these institutions.

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7.5 TYPES OF LOANS

A small scale unit as any other industrial unit requires loans for short-term and medium and long-term. Short-term finance or working capital finance is required for day-to-day operations of the enterprise and it is generally provided in the form of cash credit, overdraft facility and bills purchase and discount facility. Short-term credit is also required for stocking raw materials, parts components, sub-assemblies required for producing /assembly of the end product. Medium and long-term credit (also known as term finance) is required for acquiring fixed assets including land, building, machinery and equipment both at the time of starting an enterprise as also its expansion of productive capacity by replacing or adding to the existing equipment.

To be specific the term "finance" sanctioned in the form of "term loan" is required for :

i) Land and site development
ii) Building and civil works
iii) Plant and machinery
iv) Installation expenses, and
v) Miscellaneous fixed assets which comprise vehicles, furniture and fixtures, office equipment, workshop and laboratory equipment, miscellaneous tools including erection tools, equipment for distribution of water & power supply and treatment of water, fire fighting equipment, affluent treatment and disposal plant etc.

Another element of the miscellaneous fixed cost, particularly, in respect of units to be located in backward areas is the expenditure on infrastructure facilities like water supply, power connection, roads, transportation including railway sidings in large projects.

The short-term loans or working capital is required for the following :

a) Purchase of raw materials, chemicals, components, parts, sub-assemblies.
b) Consumable utilities, power, water and fuel.
c) Labour and managerial service facilities, wages, salaries, bonus, provision of provident funds etc.
d) Repairs and maintenance, light, rent and tax on factory assets, insurance of factory assets, miscellaneous factory expenses, contingency, distribution costs, financial expenditure including interest on loan, both for long and short-term, guarantee commissions, depreciation etc.

Working capital facilities as are available from the commercial banks may be classified as :

i) Dock and key pledge of stocks
ii) Factory/mundy type hypothecation advances (pending statement of stocks held by the Unit to be intimated to the banks)
iii) Advance against stock in process
iv) Advance against bills (when finished goods are supplied on credit)
v) Clean advance (contingency needs)
vi) Packing credit to exporters for executing export orders.

It is advisable that the working capital is never allowed to be inadequate which calls for on the one hand saving the unit from trading and on the other arranging for necessary stocks and other requirements to be pledged as per arrangement with the bank. Otherwise, the inadequate working capital can result in the following :

i) Hampers the growth of the enterprise because it becomes difficult for the entrepreneur to undertake profitable projects on account of non-availability of working capital funds.
ii) It becomes difficult to implement operating plans and achieve the targetted profits.
iii) Operating inefficiencies creep in when it becomes difficult even to meet day-to-day commitments.
iv) Sometimes the paucity of the working capital renders the enterprise unable to avail of attractive credit.
v) Fixed assets cannot be put to optimum use which affect the rate of investment.

Working capital finance is sanctioned in the form of cash credit, overdraft facility and bills purchased coupled with discounting facility working capital is physically an investment in the current assets. In any industrial enterprise initially cash is converted into raw materials which is converted into work in process and into financial goods and back to cash. This process being continuous results into blocking of some of the amount in this cycle. The working capital or the level of investment in the operating cycle depends on :

i) changes in the terms of production, sales, while other factors are constant.
ii) change in the price of raw material, time required to produce these, changes in the manufacturing techniques, process of manufacture, policy etc.

Activity 4

Take a sample of 10 entrepreneurs from your nearest industrial estate and find out from them :

a) What are the sources of their working capital finance?
b) How far are commercial banks adequately meeting their working capital needs?
c) Are all these entrepreneurs using any non-organised creditors.

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7.6 FINANCIAL INSTITUTIONS AND THEIR ROLE

Long and medium term loans are available from various organisations including National Small Industrial Corporation, Commercial Banks, State Small Industries Corporation, State Financial Corporation, etc. In addition, these Corporations have got the re-finance facilities available to them from the Industrial Development Bank of India which has recently started a separate subsidiary Institution to take care of the requirements of the small scale industrial sector. The latter is know as Small Industries Development Bank of India and it has started operating with its head office at Lucknow only during 1990. There are specialised agencies to provide long-term finance. The role of different organisations is given in the following paras :

Small Industries Development Bank of India

Small Industries Development Bank of India (SIDBI) under its Charter, has been, inter alia, assigned the task of being the main purveyor of term finance to the small scale sector in the country. Small scale industrial units, small road transport operators and artisans, village and cottage industrial units in the tiny sector are extended financial assistance mainly by way of refinance through State Financial Corporations (SFCs), State Industrial Development Corporations/State Industrial Investment Corporations (SIDCs/SIICs) and banks which have wide network of branches. This way, it has been possible to reach even the tiniest industrial unit in the farthest corner of the country.

Eligible Institutions

The institutions at present eligible for availing of refinance facilities from SIDBI comprise 18 State Financial Corporations (SFCs), 26 State Industrial Development Corporations/State Industrial Investment Corporations, 76 Commercial Banks, 196 Regional Rural Banks (RRBs), 11 State Co-operative Banks and 542 Central and Urban Co-operative Banks.

Eligibility

Term loans extended by eligible institutions to small scale industrial projects irrespective of the location and form of organisation of the unit are eligible for refinance assistance. Similarly, assistance is also made available for modernisation and rehabilitation of small industries.

SIDBI provides refinance at concessional rates of interest in respect of loans to certain special category of borrowers. The present refinance interest rate structure is given below :

ANNEXURE-2
Refinance Interest Rate Structure

(Percentages)

	I tier		II tier	
	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance
a) Basic Lending Rate (including assistance under modernisation scheme)	14.0	10.5	15.0	11.5
b) For new units in backward areas	12.5	9.0	13.5	10.0
c) For units in non-backward areas—				
(i) All loans upto Rs. 25 lakhs	13.5	10.0	14.5	11.0
(ii) All loans exceeding Rs. 25 lakhs	14.0	10.5	15.0	11.5
d) Composite Loans to artisans, village/cottage & tiny units (upto Rs. 50,000 per unit)—				
(i) backward areas	10.0	6.5	11.0	7.5
(ii) non-backward areas	12.0	8.5	13.0	9.5
e) Industrial estates—				
(i) backward areas	12.5	9.0	13.5	10.0
(ii) non-backward areas	14.0	10.5	15.0	11.5

(Percentages)

	I tier		II tier	
	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance	Ceiling on primary lenders' rate on loan	SIDBI's rate for refinance
(f) Rates of interest under specific schemes/purposes irrespective of location of the unit—				
(i) Rehabilitation assistance	—	—	10.0*	9.0
(ii) Units set up by SC/ST entrepreneurs & physically handicapped persons (upto Rs. 50.000 per unit)	—	—	10.0	6.5
(iii) Manufacture or installation of renewable energy/energy saving systems	12.5	9.0	13.5	10.0
(iv) Quality Control facilities	—	—	13.5	11.0
(g) Road transport operators (upto six vehicles)	—	—	15.0	11.5
(h) Equipment Refinance Scheme	—	—	15.0	12.0
(i) Single Window Scheme Working capital loan—				
(i) All loans upto Rs. 2 lakhs	—	—	15.0	11.0
(ii) All loans exceeding Rs. 2 lakhs	—	—	16.5	12.5
(j) Scheme of assistance for women entrepreneurs/MUN Scheme	12.5	9.0	13.5	10.0
(k) Ex-Servicemen Scheme—				
(i) backward areas	12.5	9.0	13.5	10.0
(ii) non-backward areas	13.5	10.0	14.5	11.0
(iii) Transport operators	—	—	15.0	11.5
(iv) Hotels, hospitals & tourism related activity—				
(a) backward areas	12.5	9.0	13.5	10.0
(b) non-backward areas	14.0	10.5	15.0	11.5
(l) D.G. Sets (irrespective of location and size of loan)	—	—	15.0	11.5
(m) Equity assistance under NEF/MUN/SEMFEX Schemes		— 1% service charge —		
(n) Assistance for acquisition of electromedical and other equipment	—	—	15.0	11.5
(o) Assistance for purchase of mobile sales vans	—	—	15.0	11.5
(p) Assistance to marketing organisations	—	—	15.0	11.5

*Primary lending institutions may increase the rate upto 11.5% p.a. in cases where the higher rate is justified on the basis of anticipated profitability of the borrowers.

Procedure for availing loan/refinance

Intending borrowers need approach only to eligible institutions for assistance. The refinance operations are fully decentralised and all offices of SIDBI process refinance proposals emanating from regions/states under their respective jurisdiction. The eligible institutions are required to first sanction assistance to industrial concerns and, after complying with certain procedures laid down, seek refinance sanctions and disbursals from SIDBI.

Some important schemes of the SIDBI are given below :

Composite Loan Scheme

The scheme covers composite loans upto Rs. 50,000 sanctioned to artisans, village and cottage industries and small scale industries in the tiny sector by eligible institutions. Assistance is provided for equipment finance or working capital or both. As the loans can be covered under the Credit Guarantee Scheme of DICGC, eligible institutions have been advised not to insist on collateral security.

National Equity Fund Scheme

With the objective of providing equity type or support to small entrepreneurs tiny/small scale sector and for rehabilitation of viable sick units in the SSI sector, the SIDBI provides equity fund scheme.

Eligibility

(a) Entrepreneurs setting up new projects in the tiny and small scale sector for manufacture, preservation or processing of goods and existing sick SSI units undertaking rehabilitation if they are found to be potentially viable by the financing institutions, are eligible for assistance.

(b) All industrial activities and service industries, except road transport, hotel, restaurant and hospitals/nursing homes, are eligible for assistance under the Scheme.

(c) The unit should be located in village/town having population upto 5 lakhs (15 lakhs in the case of hilly areas and North-Eastern Region). However, in the case of the rehabilitation proposals, the project could be located in towns/villages with population upto 15 lakhs.

(d) New projects which avail of any margin money or seed/special capital assistance under the schemes of Central or State Government, SFCs and other State-level institutions or banks (except Central/State Investment Subsidy) will not be eligible for assistance.

(e) The rehabilitation proposal should conform to the norms prescribed under the Rehabilitation Refinance Scheme of SIDBI for SSI sector.

(f) The unit should be registered with State Directorate of Industries/appropriate statutory authority.

(g) The unit should be eligible for assistance under the Refinance Scheme of SIDBI. Sanction of refinance in respect of term loan for the project by SIDBI is a prerequisite for extending equity type assistance under the Scheme.

(h) The total fund requirement of projects in the form of equity assistance under NEF, term loan and working capital will be provided by a single agency. Central/State subsidy may be retained for meeting working capital requirement.

Project Cost

Project cost (including margin money for working capital) should not exceed Rs. 5 lakhs in the case of new project. In the case of rehabilitation projects also, total outlay on rehabilitation should not exceed Rs. 5 lakhs per project.

Amount of Assistance

Amount required to meet the gap in equity as per prescribed debt-equity norm, after taking into account the promoters' contribution, subject to a maximum of 15% of project cost within a ceiling of Rs. 75,000 per project.

Interest

Only service charges @ 1% p.a. is payable.

Security

No security including collaterals to be insisted upon for the soft loan.

Refinance Scheme for Working Capital Loan under Single Window to Tiny and SSI Units by SFCs/SIDCs

Eligible units

New tiny and small scale units whose cost of project (excluding working capital margin) does not exceed Rs. 10 lakhs and the total working capital requirement at the normal level of operations is upto Rs. 5 lakhs, provided the unit has been sanctioned term loan for fixed assets and loan for working capital by the same institution.

Nature and amount of assistance

Working capital loan upto Rs. 5 lakhs and permissible term loan for fixed assets.

Commitment charge

Nil.

Security

First charge on fixed assets and hypothecation of current assets.

Debt-equity ratio
3:1 for the total venture outlay (i.e. cost of the project plus total working capital requirement) after taking into account the amount of investment subsidy/incentive available for the project.

Promoters' contribution
As may be required to arrive at the debt-equity ratio of 3:1.

Scheme for Women Entrepreneurs
The Scheme has been formulated with the twin objectives of (i) providing training and extension services support to women entrepreneurs and (ii) extending financial assistance on concessional terms to enable them to set up industrial units in the small scale sector.

Training and Extension Services
Programmes for training and extension services for women entrepreneurs are organised through designated/approved agencies.

Eligibility
All projects in SSI sector including cottage, village and tiny industries promoted and managed by women entrepreneurs are eligible for concessional assistance under the Scheme.

Security
As may be stipulated by the eligible institutions. However, no collateral security is to be insisted upon.

Scheme of Refinance Assistance for Quality Control Facilities by SSI Units
The Scheme has been drawn up to encourage SSI units to establish facilities for testing and quality control with a view to ensuring better market acceptability of their products. The assistance will be provided by way of term loan normally not exceeding Rs. 7.5 lakhs per project.

Refinance Scheme for Modernisation of Small Scale Industries
The primary objective of the Scheme is to encourage industrial units overcome the backlog of modernisation and to adopt improved and updated technology and methods of production and prevent mechanical and technological obsolescence. Modernisation may include replacement or renovation of plant and machinery or acquisition of balancing equipment for fuller and more effective utilisation of installed capacity. Assistance under the Scheme is need based and as such, there is no maximum or minimum limits.

Bills Rediscounting Scheme
SIDBI's assistance to small sector also flows through its scheme of rediscounting of bills/promissory notes arising out of sales of indigenous machinery to purchaser-users on deferred payment basis on special concessional rates of discount/rediscount for purchaser-users as well as seller-manufacturers in this sector. There is no minimum limit for transaction under the scheme. Banks are allowed a higher spread of 1.25% p.a. between their discounting rates so as to encourage them to cater more effectively to this sector. The facilities under the Scheme are available for purchase of machinery for expansion, diversification and modernisation. New SSI units can also avail of the facilities under the scheme for purchase of machinery. SIDBI has decided to waive the requirement of physical lodgement of bills with it, arising out of sale or purchase of machinery by SSI units irrespective of the amount involved. An advance/down payment of 15% is usually insisted upon under the Scheme with a reduced norm of 10% applicable for commercial vehicles and textile machinery. The discount/rediscount rates applicable for small scale sector are as under :

	Flat rates for Bills/Promissory notes of unexpired usance of 6 months and over	
	Rediscount (% p.a.)	*Discount (% p.a.)*
Normal*	10.25	11.50
SEBs/SRTCs	10.50	11.25
Winery/Brewery/Malt	12.50	13.50

*would be applicable to SRTOs also

National Equity Fund Scheme

With the objective of providing equity type of support to small entrepreneurs tiny/small scale sector and for rehabilitation of viable sick units in the SSI sector, the SIDBI provides equity fund scheme.

Activity 5

Contact the banker you contacted for Activity 2. How do they evaluate the role of SIDBI for the purposes of refinancing schemes?

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National Small Industries Corporation

The National Small Industries Corporation (NSIC), a public undertaking was set up in 1955, mainly to meet the requirements of 'term Loan' to the small scale units for purchase of imported and indigenous machinery and supply the same to the entrepreneurs on hire-purchase basis. This scheme of the NSIC was most-popular in 1950s and 1960s because, as stated earlier, prior to the nationalisation of the major commercial banks, this was the only agency rendering the aforesaid service to the small scale units. Commercial banks and other financial institutions had neither the charter of function nor were prepared to consider the small scale entrepreneurs as safe risk for advancing money on long and medium term basis.

Entrepreneurs wishing to avail of this scheme have to pay earnest money varying from 15 to 10% of value of machinery. In addition a service charge varying from 2 to 5%, depending on the value of the machinery and the location of the unit, has also to be paid to the hirer. The full hiring value of the machine alongwith interest on unpaid amount and service charges is payable in 13 half-yearly instalments—first instalment falling due after one year of the installation of the machinery. In case of furnaces, boilers, cold storage, plants, tyre retrading, canning, electroplating etc. the loan has to be returned in 9 instalments.

Certain special categories of entrepreneurs, such as, technocrats, physically handicapped persons, defence personnel and those belonging to schedule castes/schedule tribes are charged concessional rate of earnest money, interest and service charges. The entrepreneur is free to made his choice which, of course, is subject to scrutiny about the essentiality of the machine, technical abilities to operate, its capacity and above all, the country of import because at times due to constraints of foreign exchange shortage, NSIC may not be in a position to arrange foreign exchange from the specific country from where the entrepreneur is interested to purchase the machinery.

Prescribed application forms are available from the NSIC and its regional office/branches at the State. These have to be submitted to the NSIC or its branches at the State/District level through the Dy. Director/Regional/Jt. Director of Industries or through the respective District Industry Centre. The application has to be accompanied by latest quotations from the manufacturers of the suppliers of machinery approved by the NSIC. The details about the machinery required for individual product lies under engineering and non-engineering category can be obtained from the Small Industries Services institutes or branches of the institute set up by small scale industries development organisation of the Government of India or through the district Industry Centres. NSIC also supplies machinery to existing profit making and financially viable small scale units (with permanent registration as an SSI unit) on easy leasing term. Reputed small scale units or entrepreneurs of proven ability can also get machinery on lease basis from leasing companies on terms agreed to mutually by the parties concerned. Under this scheme, during 1980-81 to 1989-90 more than 1,10,000 small scale units purchased machinery worth 14,668,29 lacs of rupees through NSIC.

State Financial Corporations

State Financial Corporations (SFC) which exist almost in every State and Union Territory (U.T.) of the country constitute the most important single source of long-term credit to small scale industries. In view of the wide disparities in the levels of industrial development in different States and the vast size of the country in early 1960s it was felt that there was need to supplement the work of Industrial Finance Corporation of India (a Central Government institution set up for meeting the credit and capital investment needs of large scale corporate bodies) by setting up a SFC in each State and UT for granting term 'Finance' and equity capital to small scale and medium scale industries which are mostly either ownership or partnership concerns. Where there are no SFCs the Industrial Development Corporation operating in the States or UTs concerned perform the functions of the SFCs also. The SFCs have their regional offices, branches and field level offices. The loans granted by these Corporations are payable in equal annual instalments spread over a period of 10 to 12 years, the first instalment falling due for payment after one or two years of the disbursement of the loan. Generally speaking, advances are made up to 50 to 75% of the value of assets offered as security including those acquired out of the loans. Number of units covered in the scheme has been gradually interesting. During the period 1980-81, 1988-89, 2,30,839 units were covered under the scheme. The amount sanctioned to them was Rs. 5,664.52 crores and the actual disbursement was Rs. 3,858.92 crores. However, the percentage share of the small scale units from this source continues to be nearly less than 40 per cent. It may be mentioned here that the loans obtained from this source is also used for purchase of land, construction of building besides purchase of machinery.

Although there is no statutory debt equity norm (to be followed by these Corporations and Commercial Banks), normally they follow 3 : 1 debt-equity ratio while evaluating the loan applications from small scale units. This means that the unit is eligible to raise three times of its own resources by way of term "Debt". Another norm followed is the rate of promoters' contribution which is fixed in accordance with the cost of the project. The actual rate applicable would, however, depend upon the location of the project, the class of entrepreneur and the type of scheme under which the loan is sanctioned. In considering the actual amount of loan to be advanced by the SFCs, the latter have prescribed certain upper limits. The maximum amount of loan which can be sanctioned by NFC is Rs. 60 lakhs in case of limited company or Corporations Societies while the relative limit in other cases including for proprietory and partnership concern is Rs. 30 lakhs. SFCs operate various schemes for financial assistance to SSI units, most popular among these is composite loan scheme which covers both term loan and working capital upto a maximum of Rs. 50,000 under which no promoters' contribution is necessary while the integrated loan scheme enables the unit to operate upto Rs. 1 lakh inclusive of working capital component. Besides, there are other schemes also operated by the SFCs and these are meant for special type of entrepreneurs, women entrepreneurs etc. The seed capital and special capital scheme also in operation by the SFCs are intended for extension of equity types of assistance for new entrepreneurs.

The applications for loans to be submitted to SFCs are to be accompanied by a project report and other relevant information as may be prescribed by the SFCs. The applications are considered for sanction on the basis of the financial viability, technical feasibility and competence of the entrepreneur as assessed by the Corporation. The financial viability nere means the capacity of the product to operate satisfactorily, generate cash surplus, service the loans and other liability and earn a fair return on the capital invested. The technical feasibility of the project comprises the operational efficiency of the unit in terms of plant and machinery installed, spares used, raw material and other inputs, know-how/technology employed, capacity utilisation of the plant, scale of production, quality of the product, cost of production vis-a-vis the norm prescribed for particular process. On receipt of information about sanction of loan, the entrepreneur has to take steps that may be prescribed by the corporation for completing the documentation requirements to facilitate drawal of loans/ instalments according to the requirements of the unit. These would comprise execution of loan agreement, irrevocable power of attorney, promotes, deed of undertaking, guarantees etc. as may be required by the corporation.

State Level Small Scale Industries Corporation

States Small Scale Industries Corporations (SSICs) which exist almost in every State and UT render a very useful assistance in meeting the long-term credit needs of the small scale units particularly for industrial premises either in the form of self-constructed buildings or sheds in the industrial estates. In view of the varying cost of land and cost of construction of buildings.

Commercial Banks

Commercial banks in India comprise the State Bank of India and its subsidiaries, nationalised banks, foreign banks and other scheduled commercial banks, regional rural banks and non-scheduled commercial banks. The total number of branches of commercial banks are more than 45,000 and the regional rural banks approximately 8000 covering 280 districts in the country. While a major portion of the commercial banks providing assistance to the industrial sector is for meeting the working capital requirements, these banks also meet a part of the term "Finance" requirement of industrial units. According to the data compiled by Reserve Bank of India (RBI) of all the advance given to small scale industries/ sector by the commercial banks the share of the term 'Loan' is nearly 30%. As stated earlier, the lead in this regard was taken by the State Bank of India (SBI) in March, 1956 when a pilot scheme for guaranteed credit to small enterprises was started. Initially the scheme was confined to the branches of the State Bank of India at nine centres only; gradually it was extended to all other branches of the State Bank in the country. Subsequently some of the other commercial banks also introduced special schemes to assist small enterprises. Later on, the other commercial banks also adopted this scheme. Under this scheme, the banks provide to the small scale enterprises the medium term and instalment credit for acquiring fixed assets for the purposes of establishment and extension of their units and term credit for meeting their working capital needs. Instalment credit granted by the bank for purchase of machinery/equipment either new or old against the hypothecation of equipment proposed to be purchased out of the profits of these loans. The borrower is required to make a down payment of 20 to 33.1/3% of the cost of equipment to be purchased from one's own resource while the rest is financed out of the loan. The rate of interest charged on these loans varies from time to time as per directive of the RBI. The period for which this loan is granted varies from seven to ten years. These loans are repayable in half-yearly or yearly instalments. A notable step taken in the financing of the small scale industries by RBI is introduction of the "Lead Bank Scheme" under which each district, in the country has been allotted to one of the major Indian Scheduled Banks for intensive development of banking facilities.

In view of the fact that the small scale enterprises have a week capital base and they often find it difficult to offer acceptable securities. Commercial banks and other financial institutions granting loans to them as also because of their unfavourable debt-equity ratio, these units are considered bad credit risks by the lending institution. With a view to removing this impediment the Government of India have introduced a "Credit Guarantee Scheme" in 1960. Under this scheme, the guarantee organisation stands surety on behalf of the small enterprises and guarantees loans granted to them upto a certain limit against the default or bad debt. The idea behind the introduction of this scheme is that the banks and other lending institutions should have assurance of security while dealing with the small scale industrial sector. Initially the scheme was applicable to 22 districts but, later on, it was extended to the entire country and as at present a very large number of financial institutions are taking advantage of the same and are being offered guarantee cover. The scheme is reviewed from time to time and all efforts are made by the RBI to make the scheme to the best advantage of the small scale industrial units. The guarantee fee charged by the guaranteed organisation is very nominal (1.5%). According to the figures released by the Reserve Bank of India, by the end of 1989 (March), number of accounts of small scale units was 26,59,000 and the amount outstanding was Rs. 13,130 crores.

In spite of the declared policy of the Government as also of the RBI the commercial banks are still operating with the concept of security. Consequently, branches which are located in the far flung areas in the country need much to improve in their performance. Notwithstanding this lacuna it will be appropriate to mention here that the banks have got laudable scheme to assist in the promotion and development of small scale industries. Most of the banks have got specialised units in their administrative structure to take care of the financial needs of the small scale industrial units. The fixed capital needs or the long and medium term needs of the small scale units are presently being taken care of by the banks under their integrated scheme of credit for the small entrepreneurs. New units apart from the existing units are also eligible to avail of the advances financed to meet their medium and long-term credit needs for replacement of machinery, addition of the machinery, modernisation etc. The rate of interest charged normally from the small scale industrial units is between 12 and 15% as against 18% from the large scale units. Arrangements also exist in certain branches to help small entrepreneurs in filling up necessary forms and completing the other documents which are necessary for the banks to consider the loan applications from the small scale units. Unfortunately, in smaller town where the entrepreneur is yet diffident, it is considered to be in an unsurmountable difficulty with the result that many of them remain contented with the meagre resources which they can draw upon from among their family members, friends and relatives.

7.7 SCHEME FOR PROVIDING SELF-EMPLOYMENT TO THE EDUCATED UNEMPLOYED YOUTH

In the successive five year plans special consideration has been given to the unemployed particularly among the educated youth. While the results obtained have not been as per the expectation, the very idea has created awareness, among the Planners, Administrators and Development Agencies to devise and chalk out special programmes of assistance to provide employment to the educated unemployed youth. One such scheme launched in 1983-84 was to provide assistance to the educated unemployed youth to become self-employed by starting their own industrial enterprises, services and business establishments through a package of monetary assistance. Under this scheme of providing self-employment to unemployed, youth who have successfully completed their matriculation and are in age group of 18 to 35 can take advantage of getting themselves registered with their district Industry Centres which number more than 400 all over the country. Under this scheme, beneficiaries are entitled to a composite loan not exceeding Rs. 35,000/- for an industrial venture, Rs. 25,000/- for a service venture and Rs. 15,000/- for a small business venture. The monetary aspect of the scheme is implemented through the lead bank in each district. The banks are not expected to insist on any collateral security for loan upto Rs. 35,000/-. The loans sanctioned under this scheme are charged interest @ 10% per annum (PA) in specified backward areas and 12% P.A. in other areas. Repayment of the loan is made in instalments, the first instalment falling due between 6 months and 10 months after the date of disbursement of the loan. The period of instalment is spread over 3 to 7 year depending on the nature of venture and expected profitability. The recovery of the loan is the responsibility of the bank concerned. Local managers of the banks are allowed sufficient flexibility in dealing with the defaulting borrowers particularly by re-scheduling the recovery period in case of bonafide defaulters. The District Industry Centres have been asked to monitor the implementation of the scheme at district level. Besides educational qualifications and the beneficiaries mentioned above, the youth belonging to a family with an annual income of Rs. 10,000/- and below are eligible to avail of the scheme.

The progress of the scheme during the last five years as under :

Year	Target (in lakh nos.)	Application recd. (in lakh nos.)	Applications sanctioned by banks (in lakh nos.)	Amount sanctioned by bank (Rs. in crores)
1985-86	2.50	8.58	2.21	429.99
1886-87	2.50	9.10	2.17	469.91
1987-88	1.25	6.80	1.20	259.76
1988-89	2.50	6.11	1.92	404.61
1989-90	1.25	4.43	0.97	190.00

Source : Office of the Development Commissioner Small Scale Industries.

7.8 SUMMARY

In view of their inability to provide adequate collateral security, small enterprises in the past have found it difficult to meet their financing needs. From the third Five Year Plan onward, however, with the Government recognising and promoting the small sector as an important contributor to the national economy, things have changed for the better. Today in addition to the Small Industries Development Bank of India we have a number of institutions including commercial banks to meet the financing needs of small enterprises. This unit discusses the assessment of financing needs and the alternative ways of meeting these needs by the small entrepreneur.

7.9 SELF-ASSESSMENT QUESTIONS

1. What are the main sources of short and long term finance for a small entrepreneur?
2. Comment upon the position of commercial banks vis-a-vis the financing of small enterprises.
3. Discuss the various types of financing requirements that a small entrepreneur may have.
4. Discuss in detail the role of SIDBI as an institution in the context of financing of SSEs.

7.10 FURTHER READINGS

Dan Strenhoff and JF Burgess, "*Small Business Management Fundamentals*, McGraw Hill Book Company (1986).

UNIT 8 PREPARATION OF THE BUSINESS PLAN

Objectives

After going through this unit you should be able to
- discuss the importance of a business plan in the small enterprise
- explain the steps involved in preparation of a business plan
- describe the criteria to be considered while presenting a project report for purposes of industrial finances
- estimate the various projections that need to be made for your enterprise planning.

Structure

8.1 INTRODUCTION

A business plan is a written statement of what you hope to achieve in your business and how are you going to achieve it. It is a course of action that you chart for yourself in order to reach the destinations determined by you.

One of the important reasons for preparing a business plan is the realisation it brings to you about the amount of financing that you will need and the times at which you will need it. Whenever you go to a financial institutions or a tender to borrow money, they would certainly want to see how investment worthy you are, by taking a look at your business plan or the project report as it is sometimes called.

Having a plan also enables you to look ahead and prepare for future developments. In accordance with these planned developments than, you would need to start activating the enterprise in the direction that would lead you to realise those future plan. This unit gives a detailed account of how to prepare a business plan for your enterprise and the pitfalls to avoid while preparing the project report.

8.2 PROJECT REPORT—SIGNIFICANCE AND SCOPE

A project report also referred to as pre-investment feasibility study or a Business Plan is a detailed description of what business you want to be in. How the business will achieve the stated goals and when would that happen. It is an operating document.

The description of a project indicating what products are to be manufactured or what vices are to be offered (in case of a Service Venture) and to whom, constitute answers to what business? While such an operational description is relatively easy to formulate, it is ›ssential that the promoter of a business venture has 'conceptual clarity' on what business he ›r she is in. For example a manufacturer of 'drill bits' may think that the customer needs a ɗrill bit but what the customer really wants is a 'hole'. As Phillip Kotler puts it 'there are no ›roducts, there are only services performed by products.' If the manufacturer understands hat the need of the customer for a drill bit is a hole, it is most likely that the manufacturer vould keep pace with the technology advancement and may advocate, at an appropriate ›tage, use of laser technology for drilling. Such conceptualisation equips an entrepreneur vith the vision necessary to understand the needs of the 'client system'.

Details regarding infrastructural facilities required for the business, manpower, material and inancial resources needed to reach the envisaged activity level, how such resources would ›e mobilised and managed and with what financial implications constitute the answers to the ›uestion, 'How the business will achieve the stated goals'?

The time frame with in which a project is implemented when it will produce the envisaged ›utput, when the business would reach optimal activity level generating financial surplus onstitute the answer to when of a business plan.

One major issue that needs to be addressed while preparing and presenting a business plan is why is the business, who needs the envisaged output of the business (in other words, who re the clients/customers) and why would they buy the same, need to be established as a part f the marketing component of a business plan'. Essentially a business plan must establish ›hat competitive edge it has to enter, survive, sustain and grow in the market.

ctivity 1

ssume you are entrepreneur planning to start any of the following businesses

ı) A Curio shop

›) A family enterprise supplying lunch packs to office complexes.

What details would you require to define 'what, how and when and why' of the above businesses.

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hat follows is a presentation of a detailed 'outline of a business plan with notes' appended elaborate, wherever necessary, the given component.

3 EXCLUSIVE SUMMARY OF THE BUSINESS PLAN

Summary

- What is being proposed
  - Product/Service
  - Location
  - Ownership
  - Project cost
- What is wanted
  - Funding pattern including term loan and working capital loan requirement
  - Assistance regarding technical collaboration

Introduction

- Current industrial status in the country
- Current status of the industry in the international scene (if the proposed project is to

operate at international level in terms of marketing)
— Rationale for project selection

3. About the Promoter
— Educational background, work experience, project related experience.
— Similar information for any other key persons associated in promoting the project.
— If the State is one of the promoters, and if the project has international ramification with respect to marketing, technology, etc. the information regarding similar projects promoted by the State is to be provided.

4. About the Project
— Description of product and its use
— Installed capacity
— Operating capacity
(for details see 8.4)
— A write up on what will distinguish the proposed project from others already operating in the market place.
— Any legal requirements/stipulations regarding the product at national/international level? Describe.
— Clearances from government and other regulatory agencies for setting up of the project—what are they and what is the status with regard to obtaining such clearances.

5. About the Location
— Exact location of the project
— Various alternatives available which have been examined
— Criteria for selecting the location
— Locational advantages including infrastructural facilities available at the location (for details refer to 8.5)

6. Land and Building
— Area of land
— Constructed Area
— Type of Construction
— Cost
(Refer Note 4 hereafter)

7. Plant and Machinery
— Capacity
— Equipment balancing
— Suppliers
— Cost
— Various alternatives available
— Criteria for choosing the proposed equipments amongst several alternatives (Refer to 8.6)

8. Miscellaneous Assets
— Nature of miscellaneous assets that form a part of the project. For example air-conditioning systems, office automation equipments, etc.
— Itemised description of such assets alongwith cost and source of procuring.

9. Production Process*
— Description of the production process
— Process flowchart
— Details of technology
  • Has the technology been developed indigenously or would the technology be bought out from certain sources within or outside the country?
  • What are the arrangements for technical know-how?
  • What are the technology alternatives available?
  • How these alternatives have been evaluated?
  • What are the possibilities of change in the technology in the course of time and how the project proposes to adopt such changes.
  • Various process parameters.
  (Refer to 8.7)

* While the description in this write-up indicate a bias towards manufacturing ventures, the basic format of the business plan along with explanatory notes hold good, by the large, for 'service ventures' too.

10. Production Programme
    — Time required to make one unit of the product.
    — How much/how many in one week, one month, first year, 2nd year and so on upto 10 years.
    — Input-output ratio.
    — Any national or international standards set for product quality? If so how they are to be maintained with respect to production programme and production process.

11. Raw Material
    — List of raw materials needed.
    — Quantity required for one unit of output.
    — Quantity needed in the first year, second year and so on upto 10 years.
    — Quality specifications for the raw materials.
    — Sources of procurement; If the raw materials are to be procured from the international market, are there any restrictions on supply.
    — Cost of raw materials for the first year, 2nd year and so on upto 10 years.
    — Supply position, i.e. position regarding availability of the raw materials.
    — Any tie-up arrangement for procurement of raw materials.
    — Are there alternate raw materials other than what is proposed to be used? Have such alternatives been examined? Provide details.
      (Refer to 8.8 for details)

12. Utilities
    — Requirements of power, water, steam, compressed air and other consumables:
      Quantity and value for the first year, 2nd year and so on upto 10 years.
    — Source of said materials.
    — Position regarding availability of said materials.
    — Any specific arrangements for electric power.

13. Manpower
    — Requirement of skilled, semi-skilled personnel for production operations for the first year, second year and so on for upto first 10 years of project life.
    — Requirement of administrative/managerial staff and marketing personnel.
    — Cost of manpower during first year, second year and so on for 10 years.
    — Position regarding availability of skilled manpower.
    — Any scheme for training skilled manpower in case they are not readily available. Describe.

14. Market**
    A) Current market status
       — What are the major end uses of the product?
       — Are there any substitute products available in the market?
       — Is the proposed product a substitute for on already existing product in the market?
       — Who are the major buyers?
       — Who influences purchase decision?
       — What are the major criteria that a buyer looks for while purchasing the product?
       — Are there similar products available in the market? If so, what are the major attributes of such products?
       — Status regarding competitors at the regional/national level and at the international level if the project is expected to market the products in the international scene.
       — What are the major strengths and weaknesses of the competitors?
       — How the product proposed to be manufactured would differ from the products already available in the market?
       — On what strengths does the project propose to make an entry into the market and capture a reasonable market share?
       — What are the trade practices being adopted by the competitors or those producing the product currently in the market place?
       — What are the trade channels normally adopted by the competitors?

** Note: The points mentioned under the title 'Marketing' as indicated above are not exhaustive. Pl. refer to unit 6 and unit 13 of this course.

B) Proposed approach towards marketing
- The geographical area that would constitute the limit for marketing the product—regional, national, international (name/s)
- Distribution channel you wish to adopt.
- Trade practice
- The strategy that you have in mind for entering the market and promoting sales.

15. Working Capital Requirements
- What would be the stock levels of raw material, work-in-progress and finished goods? Why such stock levels have to be maintained? What is the amount involved in the stock of raw materials, work-in-progress and finished goods?
- What would be the extent of credit facilities to be offered to the buyers? It has to be reflected in terms of the cost of that quantum of goods against which payment would be outstanding at any given point of time considering the length of credit facility offered.
- Based on the above the total working capital requirement is to be calculated and the source to meet the same has to be indicated.
- If foreign currency loan is being sought for import of raw materials on a regular basis from outside the country details of the requirements have to be provided.
- What is the nature and extent of credit facilities available from the suppliers of raw materials? The same have to be accounted for while arriving at the working capital requirement.
- The arrangements for financing working capital are to be indicated. (Please refer to 8.9 hereafter)

16. Requirement of Funds
- Cost of the project giving a break-up of the cost of land, building, machineries, miscellaneous assets, technical know-how fees if any, preliminary/pre-operative expenses, contingencies and margin money for working capital. (Refer Note 8 hereafter)
- The proposed funding pattern to meet the cost of setting up the project-requirements of funds from national/international financial institutions towards capital expenditure and contribution from the promoters of the projects. Also include any other sources of funds including subsidies available from the State.

17. Cost of Production and Profitability Projections for Ten Years.
(Refer to 8.11 for details)

18. Cash Flow Statements
(Refer to 8.12)

19. Break-even Analyses
(Refer to 8.13 for details)

20. Implementation Schedule
(Refer to 8.14)

Activity 2

Talk to some successful entrepreneurs about their project planning activities. What was the sequence of information search and pattern of organisation of this information as a project report?

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8.4 PRODUCT DESCRIPTION

You must, in the first place, understand, in sufficient detail what you propose to make. It is not enough to state that you want to make aluminium collapsible tubes. The tubes have specifications. The tubes come in a range of sizes. The technical-cum-size specifications have a direct connotation in terms of use of the tube—whether it will be utilized by toothpaste producer or medicinal ointment producer. There often exist recommendatory or statutory standards which a product should fulfil (In India, Indian Standards Institute lays down such standards. These are popularly known as ISI Standards. These are available, product-wise, at a nominal price).

Capacity: A Key Parameter : It is useful to state, right in the beginning, the production capacity which you propose to instal. A back-of-the-mind awareness of such proposed capacity will tell you how in-depth a market study you need. For assessing plant and machinery and other physical facilities and later for financial viability calculations, installed capacity is the most important parameter.

On the question of capacity, remember the following :

- You must specify the number of days your factory will work in a year. It is customary to presume 300 working days. However, if it is a seasonal enterprise, because of being dependent or agricultural output (open pan sugar made from sugarcane) or part-of-the-year demand (firecrackers in India), it may work for less than 300 days. Enterprises located in areas where life gets paralysed for few months in a year on account of inclement weather may work for less than 300 days in a year.
- You must specify the number of shifts, on average, your enterprise will work everyday. One shift consists of 8 hours. One shift working is the most popular pattern among small enterprises. Three-shift working is rare, being limited largely to continuous process enterprises where production cannot be interupted for technical reasons.

Activity 3

What are the parameters in terms of product description, that would consider while developing a project report for

(a) publishing business.

(b) an industrial lubricant

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8.5 LOCATION CRITERIA AND CHECKLIST

Given a choice, you may like to establish your project in your present address town or your "home town". There is however the problem of stiff land-price, if your present address or home-town is a large city. Besides, you are aware that the government offers investment-subsidy and tax-concession to entrepreneurs setting up enterprises in specified areas. You are also aware that you need various physical and commercial facilities to run an enterprise. Present-address town or home-town, thus, is no longer an automatic location-choice. You have to consider a gamut of points while deciding upon a location. There is, in addition, the task of choosing a site—the specific piece of land, in a given town, where the enterprise will be located. Sometimes, the location-selection and site-selection are intertwined in so far as you may drop a location for want of a good site.

How will you go about location/site selection? We recommend a two-stage procedure. For practical reasons, just a few locations are likely to merit consideration. Under the first stage, identify two or three such locations. Also identify one or two sites at each location. Under the second stage, examine each location/site in terms of a six-dimension location/site selection checklist given below.

Even if you have just one location/site in view, it is useful to evaluate it in terms of the checklist to make sure that you are not making a major error. The six dimensions of the checklist are :

1. Basic Considerations (Development status of the town and its location with reference to enterprise needs)
2. Physical Infrastructure Position (Power, Water, etc.)
3. Commercial Infrastructure Position (Telecommunication, banking etc.)
4. Social Infrastructure Position (Housing, Health etc.)
5. Financial Incentives Position (Investment Subsidy, Income-tax concession etc.)
6. Site-specific considerations (Land Price, Contours etc.)

So, put down your finding against each point in the checklist before you pass the final comment on any location.

The checklist is enclosed.

Checklist for Location and Site Selection
Basic Considerations : Dimension I.

1. Location (City/Town/Village)
2. Population
3. Nearest large city (Name and Distance)
4. Connections to major cities (Rail, Road, Air-distance, Connection, Frequency)
5. Climate (Minimum/maximum temperature, humidity, minimum/maximum rainfall)
6. Distance from important geographical markets
7. Distance from major raw material sources and significance (or lack of it) of enterprise proximity to such sources
8. Distance and connection to relevant ports (in case of export/import oriented enterprises)
9. Manpower : availability of required skills and prevailing wage rates
10. Overall industrial relations (strike/lockout/dispute in the area)
11. Law and order position in the area
12. Level of industrial development in the area and anticipated tempo.
13. Composition of industrial development in terms of types of industry and size/health of existing enterprises.[1]
14. Proposed enterprise and govt. preference for type of industries at proposed location.[2]
15. Whether ready built-up factory shed is available at the location and whether its size conforms to your need.

Activity 4
With reference to the entrepreneurs you contacted for Activity 2 evaluate the location decision on the checklist provided above.

1. An eletronic enterprise may suffer from an environmental hazard if industries in the area are predominantly chemical. A strong presence of large industries may ensure quick development of facilities but push up housing cost and wage-levels. Wide-spread industrial sickness in an area may dilute governmental interest in area development programmes.

2. The Government may wish concentrated growth of a particular industry—electronics or ceramic or any other—at a given location. The facilities meant specifically for such industry will develop quickly there. Likewise, the government may wish to keep certain industries—water intensive or noise-intensive—away from certain locations.

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Physical Infrastructure Position : Dimension II

1. Land : Availability and Price
2. Whether there exists an organized industrial estate.
3. Water-supply : Source (river, canal, tubewell), distance, quality (pH, Hardness), rate, common storage facility, operating authority (Public Works Department, industrial estate authorities corporation, municipality).
4. Power Supply : Nearest substation, feeder type (industrial/rural).
5. Effluent-Treatment and Disposal (if relevant): Disposal point (land, sea, river), arrangement for treatment (individual, common), drainage arrangement for conveying the effluent (open, underground), treatment and conveyance charge.
6. Approach road/internal roads
7. Street lighting
8. Responsibility for maintaining roads, drainage and street lighting (a single or multiple agencies).
9. Annual maintenance charges.

Commercial Infrastructure Position : Dimension III

1. Telecommunication (availability of new telephone connections, manual or automatic exchange, STD facility, Telex facility, etc.)
2. Postal and telegram facility
3. Banking facility
4. Transport-operator facility
5. Weighbridge
6. Typing/photocopying
7. Courier
8. Warehousing
9. Nearest offices of law-enforcing agencies (excise, sales tax, labour laws, factory inspection, pollution control etc.).
10. Nearest Offices of Industry-assisting agencies (State Finance Corporation, Industrial Estate Corporation, Raw material/Marketing Corporation, District Industry Centre which sanctions and disburses financial incentives).
11. Building/Electrical/Fabrication contractor facility.
12. Building material, spares parts and such other shops.
13. Motor-rewinding, painting, gas-supply and such other industrial services.
14. Technical educational facility (e.g. Industrial Training Institute, Polytechnic).
15. Professional resources position (management/industrial consultants, financial/legal advisers, management/productivity associations).

Social Infrastructure Position : Dimension IV

1. **Housing :** Availability, Quality, Price (ownership and rent), Public Housing (Actual and Planned housing by State Housing Board, Infrastructure Corporation or such other agencies).
2. **Education :** Primary, secondary and university education facility (quality, number of seats, ease of admission, medium of instruction).

3. **Health :** Dispensary, hospitals, specialities.

4. **Recreational Facility :** Cinema, restaurant, library, parks etc.

5. **Hotel Accommodation**

6. **Service Organisations :** Rotary, Lion etc.

Financial Incentive Position : Dimension V

1. Investment subsidy (from the Govt.)

2. Income-tax concession.

3. Sales tax exemption/interest-free sales-tax loan.

4. Promoter contribution (margin) and interest-rate policy followed by Finance institutions.

5. Electricity-duty exemption, local-tax exemption and such other incentives.

Site-specific Consideration : Dimension VI

1. Whether the proposed site is a part of an organised industrial estate.

2. Direction of town-growth with reference to the site.

3. Non-agricultural status of the site.

4. Site-contours (levelled, hilly, pits, ravines, brick-kilns).

5. Site-shape (regular/irregular)

6. Immediate proximity of railway line, national highway, state highway.[1]

7. Overhead telephones or powerlines or underground water/drainage/gas line passing through the site.[1]

8. Access to national/state highway or other roads provided by the site.

9. Wind direction in relation to the site.

10. Soil-type.

8.6 PLANT AND MACHINERY—SPACE CONSIDERATIONS

It is necessary to identify the complete range of machines and equipments required to carry out manufacturing/auxillary operations and to specify the capacity and technical features of individual machines.

So far as capacity is concerned, the emphasis should be on balancing. A polyurethane foam project involves machines for foam-making and then for cutting slabs into required sizes. The foam-making is very rapid while cutting is slow. In most cases, cutting machines capacity is so low that production remains at 10% of foaming machine capacity level. So, cutting machine consitutes a bottleneck to achieving desired overall plant-capacity. Such bottlenecks must be avoided. Likewise, excessive investment in the capacity of a single equipment is undesirable.

While firming up a plant and machinery list, it is essential to arrive at 'make or buy' decisions. The producer of a collapsible tube may decide to make slugs on his own or to procure these ready from the market. In the former case, he needs a power press. In the latter case, he does not need it. So, decide what you are to make and what you are to buy before you draw up a list of machinery.

The suppliers sometimes exaggerate the capacity of a machine. The claimed capacity (quantity of output per 8 hours) is often with reference to ideal operating conditions which do not exist. The actual capacity, therefore, turns out to be lower than claimed. So take

1. This may imply leaving out some portions of a plot for building purpose.

supplier-claims with a pinch of salt, make enquiries with entrepreneurs who are operating the machine and utilize, if necessary, a suitably downward revised capacity estimate for working out enterprise performance projection.

Machinery List : An Illustration

Please look at an illustrative list of machinery below. This is for aluminium collapsible tube enterprise envisaged to have a capacity to produce 75 lakhs tubes per year on a single-shift, 300-day working basis.

While all machines, in this case, will be utilized well, the power press and to some extent offset printing machine will be utilized for fewer hours—say 4 or 5 hours per shift of 8 hours. There is no practical alternative to this. It may be observed that there are two components of machinery—extrusion and other machines to make tubes and machines to maintain and make dies and accessories. We have called tube-making machines the main plant. The dies are required for each tube-size and they wear out. Lathe and other equipments—what we have called toolroom equipment—are required to make and maintain dies.

Details of Plant and Machinery : Aluminium Collapsible Tube Project

Sl. No.	Machine	Qty.	Cost (in Lakhs' Rs.)
	I. MAIN PLANT		
1.	Extrusion Press : 100 ton capacity speed of 30-60 strocks/min. with 25 HP motor stardelta starter, die-set & accessories	1	1.70
2.	Automatic trimming machine : speed 40-60 tubes/min. with clutch reduction gearbox, 2 HP motor and accessories	1	0.75
3.	Rumbling barrel with 1 HP motor & gearbox	1	0.09
4.	Annealing furnace for slug & tube with 3 trays, 10 KW rating	2	0.25
5.	Tubecoating machine : speed 40-60 tubes/min. Autofeed type with 2 HP motor, reduction gearbox	1	0.65
6.	Four colour offset tube printing machine : speed 35-60 tubes/min. with 3 HP motor, gearbox, starter	1	1.40
7.	Drying-oven capacity 40-60 tubes/min. max. temperature 250°C	1	0.70
8.	30 ton capacity power press with suitable electric motor	1	0.40
	TOTAL (A)		5.94
	II. TOOL ROOM & MISCELLANEOUS EQUIPMENT		
1.	Lathe 15 cm. bed, suitable for precision work with motor & accessories	1	0.30
2.	Drill machine, pillar type 2.5 cm capacity with motor & accessories	1	0.04
.	Hackshaw machine 22.5 cm capacity with motor	1	0.03
.	Surface grinder, table size 45 × 150 cm hydraulically operated table driving mechanism with motor & accessories	1	0.28
.	Welding transformer, 400 amps with accessories	1	0.07
.	Bench grinder 22.5 cm wheel size	1	0.02
.	Weighing scale, platform type 1 ton capacity	1	0.05
.	Extra dies, instruments		0.07
	TOTAL (B)		0.80
III.	TOTAL A + TOTAL B		6.80
IV	Freight, Insurance, Sales-tax Octroi, etc. @ 10% of III		0.68
V	Erection material & charge @ 5% of III		0.34
VI	GRAND TOTAL (III + IV + V)		7.82

Note : All equipments can handle tubes having 13-35 mm diameter.

These are major considerations. Some term lending organisations maintain a list of approved suppliers. In this case, ascertain whether the selected supplier is on such an approved list. In any case, make sure that he is not black-listed by the term lending agency.

We have discussed the question of computing the cost of plant and machinery under the subject of project cost. For the time being, it is pertinent to point out that it is customary to get offers or quotations from the suppliers and to carry out a comparison of these in order to convince the term loan organisation that you have made the most judicious supplier selection.

Old Machinery : Need for Caution

If you are buying old machinery you must satisfy yourself regarding the present conditions of such machinery and its value and residual life. The term loan organisations, but for imported machinery, may not lend any money at all against old machinery. It is advisable to check the policy of term-loan organisation before deciding to acquire second-hand machinery.

Identification of Sources of Machinery

You may ask—How does one identify sources of plant and machinery? The person responsible for providing technical know-how is normally in a position to pinpoint such sources. However, there are directories of machinery manufacturers brought out by term-loan organisations, industry associations and research organisations which you can profitably utilize. Owners of similar existing enterprises can shed considerable light on sources of machinery.

Activity 5

Choose a sample of ten entrepreneurs who are in manufacturing business. Find out from them

(a) How did they identify sources of machinery?

(b) What were the considerations in machinery supplier selection?

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Dies, Spares and Extras

Your job extends beyond identification of equipments and laying down capacity and specifications of such equipments. There are dies and spares to be bought alongwith machinery. It is important to appreciate the significance of these 'extra' or 'optional' items. The dies often hold the key to determination of your product-range and production capability. The absence of critical spares can cause lengthy production shut-downs. So, consult your technical associate, interview machinery suppliers, discuss the experience with present users of equipment and work out a statement of dies and spares which you must buy initially.

Machinery Supplier Selection

Next, there is the question of machinery supplier-selection. It is not necessary—on most occasions, not possible—that all machinery comes from a single supplier. The supplier-to-supplier comparison normally rests on the following considerations :

- technical features of equipment offered by individual suppliers
- reliability of equipment offered by individual suppliers
- price of equipment offered by individual suppliers
- delivery period stipulated by individual suppliers and their respective reputation in terms of delivery schedule fulfilment
- nature of warranties or performance guarantees offered by individual suppliers
- scope of after sale service, terms and conditions of such service and reliability of such service offered by individual suppliers.

Space Consideration

We have already discussed the issues of location/site selection. As a general policy, it is wise for a small-scale entrepreneur to locate the enterprise in an organised industrial estate so that he does not have to deal with such problems as land development (filling or levelling), provision of utilities, encroachment and security. There is, however, the question of amount of land an entrepreneur should acquire. In this behalf, the following considerations are relevant :

- Compute the built-up area requirement and ascertain the building regulations.
- Your enterprise may grow and you may wish to raise installed productive capacity. It is prudent to keep a provision for expansion of built-up area in the future. A popular practice is to provide this @ 100% of built-up area proposed for construction in the initial years.
- You must consider the open storage area which you will need, if such storage is to occupy a large amount of open space. A mini paper enterprise devotes a good deal of open space to storage of rice straw.
- Do not forget to take into account the laws. These laws may pertain to construction restriction.

Given built-up area need, it is not difficult to arrive at the land requirement. The question, however, is—how does one fix the built-up area requirement?

In the first instance, it is essential to visualise the built-up area separately for the following purposes :

- Production (Factory)
- Auxillary Services (e.g. laboratory, workshop, steam supply)
- Administration (Office)
- Godown
- Miscellaneous non-factory purposes (security-cum-time cabin, excise cabin etc.)
- Silos, tanks, wells, cisterns etc.

A small enterprise may not require space for some of the above cited purposes. It is, however, useful to assess the requirement purposewise and it is essential to work out the layout plan accordingly. Based on the layout plan, you can compute the gross amount of required built-up area.

It is not sufficient to determine the built-up area requirement. The building specifications—length, width, height, type of construction—must be worked out. The specifications will flow from the technical considerations. In texturising industry, double-storyed structures are common since machinery is light while in most industries, single-storey is the norm. Most factory building have asbestos roofing while in pharmaceutical reinforcement cement concrete roofing is customary.

Once the built-up area, size and specifications are settled, it is useful to consult a civil engineer or a contractor. You will get a cost estimate.[1]

If your project is large or involves complicated building design, it may be desirable to seek the services of an architect.

Activity 6

Assume that you are establishing a factory to manufacture polypropylene sheets. Talk to a manufacture in the small sector of this product and assess the space required for a small scale organisation.

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[1] It is useful to bear in mind the general cost of one square metre of factory building prevalent in the area. This will give you a quick, preliminary estimate of factory-building cost.

8.7 TECHNICAL FEASIBILITY AND KNOW-HOW

Technical Feasibility

You will often come across a reference to technical feasibility of an enterprise. In simple words, the concept of technical feasibility denotes adequacy of the proposed manufacturing process and plant and machinery to produce a given product largely within the framework of predetermined quality-specifications, raw-material and utility-consumption levels and output quantity per 8 hour norms, without long or expensive break-down problems. We are devoting this part to a discussion of technical feasibility. However, we shall touch upon, in the course of this discussion, on some commercial points intertwined with technical feasibility.

Scope of Technical Arrangements

In order to accomplish technical feasibility, you must make sound technical arrangements. For a small enterprise, the technical arrangements normally over the following :

- laying down the manufacturing process.
- working out the specifications of plant and machinery, identifying possible sources of supply, evaluating offers from various suppliers and formulating a machinery procurement-cum-erection plan.
- preparing a factory layout plan and assessing built-up area requirement.
- selecting a location/site.
- estimating raw material and utility (power, water, fuel) consumption norms, selecting equipment-systems required to ensure a satisfactory supply of utilities and assessing capital expenditure required to install such equipment/systems.
- coping with anti-pollution law.

Before we discuss these components of technical arrangements, let us highlight the question of technical know-how.

Provision of Technical Know-how

You need a fund of knowledge to carry out the above-cited and related technical tasks. In other words, you need technical know-how.

If you are a technocrat possessing experience in the business-line you want to set up, you already have such know-how. If it is a low-technology project—say making wirenails—you may be able to acquire a quick technical appreciation through exposure to existing enterprises, interaction with plant suppliers and may be in a position to undertake the technical tasks through a combination of quick appreciation and hiring of an experienced technician.

Depending on technology-content of your enterprise, you may contemplate seeking assistance from a specialised technical consultant. While seeking such assistance, satisfy yourself that the consultant is knowledgeable and dependable. If his knowledge is poor, you will end up with wrong machinery and defective process and not be able to produce the desired product at a reasonable cost. Check the track-record of the consultant and watch for yourself work he may have done earlier. Pay attention to drafting your commercial contract with the technical consultant to make sure that he does not leave you halfway or does not do a shoddy job.

Whether you are dealing with a technical consultant or a research organisation, bear the following in mind.

What works at the laboratory scale sometimes does not work at the commercial scale. One is forced to make modifications in the design of equipment, raw material composition or construction of equipment-material in the process of scaling up. The final outcome, in view of this, becomes somewhat uncertain. A manufacturer of magnesium oxychloride tiles could not manufacture it because the process borrowed from a national research organisation was meant for laboratory and not for continuous fair-scale production. A producer of furfural was forced to drop the initially chosen raw material, viz., corn-cob because the yield was lower than original projection. Many chemical plants switchover from mildsteel to stainless steel equipment, thanks to corrosion problem. Thus, utmost circumspection is called for in case of technology-oriented small projects. It will be prudent to ask another technocrat to look at the technology in respect of such projects. Besides, a financial provision for further technology-related work to ensure technical feasibility must be built into the project cost.

There are instances, rather rare, of a small enterprise having to borrow technical know-how from abroad. This is called foreign technical collaboration. There are legal provisions in force from time to time which specify products for which such collaboration will be allowed and the permissible terms and conditions for it. If you contemplate such collaboration, you must check the policy/legal provisions. So far as foreign collaborator is concerned, assess the capability. It is worthwhile to secure offers from a few prospective collaborators and get the best deal. The provision of technical know-how in case of foreign collaboration normally encompasses supply of equipment, drawings, erection-support, training of Indian manpower by the collaborator. It is important to ensure that all mutual obligations are spelt out comprehensively and carefully in the collaboration agreement.

There exist voluntary/public organisations which can provide help to a small enterprise in locating foreign suppliers of technology and sometimes in bringing about a tie-up.

8.8 RAW MATERIALS

You will have to do a fair amount of techno-commercial work on the subject of raw materials. The work must cover following points :

1. Identify all raw materials required for producing the proposed product.
2. State clearly the specifications of all such raw materials.
3. Analyse raw material loss at each stage of production process.
4. Identify all chemicals, stores, consumables and packing material required for producing the proposed product.
5. Workout the consumption norms in respect of raw material, chemicals, stores, consumables and packing material per unit of output.
6. Identify bought-outs required, the rate at which they are required per unit of finished output, the price of brought-outs and the names of prospective suppliers.
7. State whether (which) raw materials are available indigenously or imported.
8. In case of imported raw materials, describe the clearances/licences required and thus give an idea regarding ease of import.
9. State names and addresses of major suppliers of raw materials.
10. Ascertain the (prevailing) price of various raw materials, chemicals, stores, consumables and packing materials. Comment on the volatility or otherwise of price.
11. Add taxes, freight, duties, excise, octroi and such other charges to the price.
12. Ascertain the credit-period which suppliers normally grant to the buyers.
13. Comment on availability of major raw materials—whether these materials are easily available or are occasionally or continuously in short supply.
14. Whether there is a price control on raw materials. If so, the details of such control.
15. Whether there is a distribution control in respect of raw materials. If so, give details pertaining to registration status, quota allotment expected and so on.
16. Incidence of loss of material in transit or storage, if such incidence is significant.

Activity 7
In consultation with the respondents you chose for Activity 6, try to find out the raw material cost for your products. How much bank financing can you expect for this estimate of raw material?

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8.9 WORKING CAPITAL COMPUTATION — A CHECKLIST

(1) What is the expected capacity utilisation or output (in physical terms) during the first year of operation?

(2) In order to produce output, as envisaged under No. 1, the quantity of raw material required and the unit price of each raw material. If there are multiple raw materials, state the requirement/unit price separately.

(3) Determine the quantity of raw material which your enterprise, given first production target, must carry. This may be equivalent to 15 days or one month or two months or any other period's requirement. While determining carrying-level, it is useful to keep the following in mind.

- If it is an imported raw material, an enterprise generally likes to carry a relatively large—a few months—requirement since the time lag between order placement and procurement is considerable.
- An enterprise carries a heavy inventory of a raw material which is frequently in short supply or which takes long to arrive after order-placement.
- If the raw material price is volatile, an enterprise tends to stockpile it to take advantage of a favourable price.
- If the raw material is available on a seasonal basis, an enterprise is forced to carry a large volume, e.g. agricultural raw materials.
- There may be in operation in a law which limits raw-material levels e.g. edible oils.

(4) Ascertain the value of raw material which the enterprise will keep in stock. This is a product of quantity of raw material fixed under 3 and the unit price of raw material.

(5) Carry out the exercise identical to what you did for raw material in case of stores, spares, consumables, packing material and arrive at the value of these which the enterprise will keep in stock.

(6) Estimate the value of goods in process which the enterprise will carry at any point of time. This will depend on the length of manufacturing cycle. Suppose, there is a Ghamela (a pan-like article used for material handling in civil construction and farming work) enterprise which is expected to produce 1,50,000 Ghamelas by working 300 days (single-shift) during the first year. It needs two days to complete raw material to finish product process. This means the length of manufacturing cycle is two days. In other words, 1000 Ghamelas will remain under process at any point of time. No. of Annual output units × Length of Manufacturing Cycle in Days. No. of Working Days in a Year. How does one put value on such goods under process? Take all direct cost-raw material, wages and utilities. Ignore depreciation, administrative and selling cost.

(7) Estimate the level of stock of finished goods which the enterprise will generally carry. This may depend on whether it produces against orders or in anticipation of demand. An enterprise producing against firm orders carries no or little stock (limited to time taken to get transport or to cover cancellation of firm orders) of finished goods. In contrast, an enterprise selling in anticipation of orders always carried some stock of finished goods. If the demand is seasonal, e.g. firecracker, the enterprise may have to carry a large volume of finished goods. The quantity of finished goods stock should be valued at cost—direct as well as indirect (exclude only depreciation).

(8) Segregate your total sales in cash sales and credit sales. Assess the credit time limit which you will have to grant. This will furnish to you the amount of outstanding book debts. While putting value on sales, exclude your own profit. In other words, consider production cost of sales.

(9) The amount required to meet one month's wages and salary bill.

(10) Cost of fuel, light, power and other utilities for a month.

(11) Administrative and selling expenses and repairs and maintenance for a month.

(12) Total-up 4, 5, 6, 7, 8, 9, 10 and 11. You will arrive at the gross working capital requirement.

(13) The bank extends credit against the following components :
- Raw Materials
- Goods in Process
- Stores, Spares, Consumables, Packing Materials
- Finished Goods Stock
- Book debts

The bank does not give credit against wage and salary utilities (No. 10) and administrative/selling/repair expenses (No. 11). Against permissible components, credit is generally granted @ 70% of total requirement. This may, however, differ from component to component, project to project or time to time.

A bank may grant credit @ 75% of requirement in case of raw materials, stores/consumables, 50% of requirement against goods in process, 60% of requirement against finished goods and 70% of requirement against book debts. It is useful to check the component-wise margin policy with a bank before you finalise bank assistance estimate. 70% against all components and no assistance against expenses (wage, salary, power, fuel, administration, sale) is a generalised thumb rule.

8.10 PROJECT COST COMPONENTS

I. Land and Site Development
- — Cost of land
- — Land-related legal charges
- — Levelling and filling charge
- — Approach/Internal Road Charges
- — Fencing/Compound Wall charge
- — Cost of Gates

II. Building and Civil Works
- — Factory Building
- — Office, Godown and such other structures at project site
- — Well, Tank, Silos, Garage at project site
- — Sewer, Drainage
- — Architect Fee

III. Plant and Machinery
- — Price of Machinery
- — Excise-taxes, freight, packing, transit insurance and octroi in respect of machinery
- — Stores/spares bought alongwith machinery
- — Foundation and installation cost

IV. Other Fixed Assets
- — Furniture
- — Office equipments
- — Miscellaneous tools and equipments
- — Vehicles
- — Equipment, Cabling for distribution of power
- — Equipment and piping for water supply
- — Laboratory equipment
- — Workshop equipments
- — Fire fighting equipments
- — Effluent collection, treatment and disposal arrangement
- — Boiler
- — Diesel Generating set
- — Other Assets

V. Technical Know-how Fees (Training Cost Included)

VI. Preliminary and Pre-operative Expenses

- — Firm-floatation
- — Feasibility Report
- — Capital Raising .
- — Salary and Administrative cost during implementation period
- — Rent, Rates, Taxes during implementation period
- — Travel Cost during implementation period
- — Interest during implementation period
- — Insurance during implementation period
- — Mortgage expenses in respect of loan
- — Trial Product Cost

VII. Working Capital Margin

VIII. Contingency and Escalation (generally @ 10% of I to IV)

Cost of production and profitability projections

While estimating cost of production and profitability, asumptions are to be explicitly stated. For example one may like to work out the projections on an annual basis over a period of time at 'constant cost' constant selling prices. To illustrate, an entrepreneur planning to manufacture injection moulded plastic goods may project cost of production over a period of five years considering the cost of raw materials to be the same year of year. Another approach is based on historical data. Other factors one may consider higher cost levels over a period of time and corresponding (if not proportionate) increase in selling prices. Further, one may take into account the cost of raw materials at a particular level different from the prevailing market rate based on certain long-term tie-up arrangement envisaged as a part of the project. Such assumptions are to be explicitly stated.

By the time one reaches the stage of estimating cost of production and profitability, it is obvious that all cost elements-would have been individually and descriptively worked out and depicted in a separate statements. Thus, the exercise of preparing cost of production and profitability statements amounts to compilation of the data already gathered or processed and presenting the same in a particular format. Enclosed herewith is a format indicating various elements that go into cost of production and profitability statement. Given the basic structure of the format, modifications need to be done to suit the nature of the business. Thus, the enclosed format is suggestive.

Estimate of Cost of Production & Profitability

(Rs. in lakhs)

Operating year	I	II	III	IV	V	VI	VII	VIII
Capacity of the plant								
Production in unit								
Capacity utilisation								
A. Material Costs								
a Raw material								
b Components								
c Consumables								
d Packing materials								
Total material cost								
B. Utilities								
a Power								
b Water								
c Fuel								
Total utilities cost								
C. Labour and Plant Overheads								
a Direct wages								
b Factory supervision salaries								
c Bonus, provident fund, gratuity								
Total labour cost								

Operating year	I	II	III	IV	V	VI	VII	VIII
D. Factory Overheads								
a Repairs and maintenance								
b Rent and taxes								
c Insurance								
c Insurance								
d Miscellaneous factory expenses								
e Contingency								
Total factory overhead cost:								
E. Estimate of cost of manufacture = A + B + C + D								
F. Administrative Expenses								
a Administrative Salaries inclusive of Gratuity, P.F. Bonus								
b Remuneration to Directors								
c Professional fees								
d Postage, telegrams and telephones								
e Insurance and taxes on office property								
Total administrative expenses								
G. Selling expenses and sales promotion								
a Advertising								
b Packing								
c Selling commission								
d Taxes/excise duty								
e Royalty								
Total cost of selling & sales promotion								
H. Total cost of production: = E + F + G								
I. Selling price total sales								
J. Gross profit before interest = (I-H)								
K. Financial Expenses								
a Int. on LT loans								
b Int. on working capital								
c Guarantee commission								
Total financial exp.								
L. Depreciation W.D.V.								
M. Operating profit = J – K – L								
N. Other income if any								
O. Preliminary expenses written off								
P. Profit/loss before taxes = M + N – O								
Q. Provision for taxes 20%								
R. Profit After Tax								
S. Net cash accruals (L + M + O + P)								

Break-Even Analysis (BEA)

As a part of the business plan, the activity level of a business—in other words, quantum of production of goods or services as the case may be—is projected over a period of time, i..e. 5 to 10 years or even more depending on the nature of the business. However, when the business plan is implemented, there are several factors that came into play towards realisations of the targeted activity level. Unforeseen shortages of raw materials, disruption in power supply, inability to penetrate the market etc., may curtail targeted activity level. What would be the financial implications of such even finalities?

To what extent a business can afford to curtail its activity level due to a variety of compulsions and yet manage to meet all its liabilities. These questions need to be answered right at the stage of preparing a business plan so that the entrepreneur as also financial institutions intending to fund the business are in a position to assess, though partially, risks involved. The said questions could be answered through break-even analysis—an analysis of the relationships amongst costs, production level and profit. What follows is an outline of the concepts of BEA and the mechanics involved in calculation of Break-even point.

Break-Even Analysis

In order to carry out profit-oriented activity, may be production of goods through setting up of a factory or provision of services by setting up an automoblle workshop or hotel/repairs shop, certain costs are involved. Various items of costs may be the raw material cost, salaries/wages, interest charges and the money you have borrowed for setting up the unit etc. All these items of cost put together form the total cost.

The cost components can be divided into two major types viz. (i) Fixed Cost and (ii) Variable Cost.

Fixed Cost

Fixed cost is that cost which does not vary or change with other factors in the production level. In other words, there are certain items of cost such as. interest on 'long-term loan', rent on factory shed or office if they are rented, depreciation on machinery and building if they are owned, etc. which are to be incurred whether the factory or service centre is working at full capacity or not. For example, if an entrepreneur has borrowed Rs. 1 lac from a bank or State Finance Corporation for buying machinery for his factory to produce 100 Tons of a product per year (product A) and the interest rate on the loan is 12.5%, he will have to pay Rs. 12,500 as interest per year irrespective of the fact that the production is 10 Tons or 15 Tons or absolutely nothing. Let us go through another illustration. A factory building is rented and the rent per month is Rs. 1,000. The production on monthly basis is 500 units in January, 800 in February and 600 in March. Now, the question is what is the fixed cost for the factory as such for the months of January, February and March? Likewise, what is the fixed cost per unit of the output in these months?

The fixed cost for the factory unit as such, assuming that there are no other costs, would be Rs. 1000 per month for each of these 3 months. The fixed cost per unit of the output can be obtained by dividing fixed cost for a month by the number of units produced/to be produced for that month as noted below:

Month	Fixed Cost/No. of Units	Fixed Cost per Unit of output
January	1000/500	Rs. 2.00
February	1000/800	Rs. 1.25
March	1000/600	Rs. 1.66

Another interesting point one could note from the above example is that though the total fixed cost for the factory as such remains constant (i.e. Rs. 1000 per month), there is an increase in fixed cost per unit of the output when the production decreases and likewise. there is a decrease in the fixed cost per unit when the production increases.

Variable Costs

Variable cost is variable with the level of production i.e. variable cost is directly related to the quantity of output. For example, if Rs. 100 worth of raw-materials are needed to produce 1 ton of Product A, the variable cost can be calculated as below (Assuming that there are no other variable costs):.

Raw-material cost per ton of output
i.e. variable cost per kg. = Rs. 100

Month	Output	Variable Cost
January	500 kgs.	Rs. 50,000
February	800 kgs.	Rs. 80,000
March	600 Kgs.	Rs. 60,000

As could be seen from the above illustration, that the total variable cost for the venture as such increases/decreases alongwith the increase/decrease of production level. But the variable cost remains constant for each unit of the output.

In short, any item of cost which does not change with the level of production is 'fixed cost' and that item of cost which changes with the level of production is 'variable cost'. Fixed cost is fixed for the venture as such. But fixed cost per unit of the output varies with change in production level/activity level. Total variable cost for the venture as such is variable as per the production level. But variable cost per unit of output remains constant. (Here we are not going into the intricacies of economies scale.)

When we make an attempt to classify various items of cost into fixed and variable cost we may come across certain items of costs such as, wages which remain fixed till a particular level of production is reached but vary whenever that level is crossed. In other words, there are certain items of cost which can be termed as 'semi variable'. But for the operational convenience, it is sufficient if one could classify the cost components into fixed and variable without going into further analysis.

Having understood the level of Fixed Cost and Variable Cost, let us now see how best we can understand the concept of Break-Even Point.

Calculating Break-Even Point

Whenever an entrepreneur estimates profit for his venture at the time of preparing the project report or making projections for the coming year (when the unit is already in operation), normal approach is to deduct total Cost from Total Sales Revenue to arrive at Gross Profit.

Suppose, he goes a step further and calculates profit at two stages by splitting the Total Cost into Fixed Cost and Variable Cost for the project, the analysis will throw some light. It is known that Variable Cost per unit of the output remains the same. Hence, given the same selling price, the difference between Variable Cost per unit and selling price per unit which we call 'Contribution' also remains the same. Thus, as sales go up, the Contribution (difference between Sales Revenue per unit and Variable cost per unit × No. of units) also goes up. Given the fact that the Fixed Cost for the project remains the same, the venture has to at least earn enough money to meet the Fixed Cost. In other words, if loss is not to be incurred the venture must sell enough number of units of the output so that the contribution is equal to the Fixed Cost. The profit would be to the extent of the Contribution which is in excess of Fixed Cost.

Such a 2-stage analysis to identify the production level at which the venture makes neither profit nor loss is called Break-Even Analysis. The said production level is called Break-Even Point.

We can now put it mathematically as below:

i) Total Cost at 'X' Production Level = Variable Cost for 'X' No. of Units (VC) + Fixed Cost.

ii) Contribution (CN) = Sales Revenue (SR) – Variable Cost (VC)

iii) Profit (P) at 'X' level of production = (Sales Revenue for 'X' No. of Units) – Total Cost.
i.e. SR – (VC + FC) Or SR – VC – FC
i.e. Profit = Contribution (SR – VC) Fixed Cost (FC)

To clarify the concept, let us now look at the illustration mentioned below. The calculations are done at 3 different production levels to illustrate the relation between the level of production and profit.

Selling Price per Unit	Rs.	10.00
Variable Cost per unit	Rs.	4.00
Fixed Cost for the Project	Rs.	90,000.00

Production Levels

	10,000 Units	15,000 Units	20,000 Units
Sales Revenue (SR)	1,00,000	1,50,000	2,00,000
Variable Cost (VC)	40,000	60,000	80,000
Surplus (SR – VC)	60,000	90,000	1,20,000

This surplus i.e. 'Contribution' is not profit as we have to meet Fixed Cost also. Considering the Fixed Cost for the Project is Rs. 90,000 then at 10,000 units production level, the company is incurring a net loss of Rs. 30,000 (Rs. 60,000 – Rs. 90,000); at 15,000 units production level, there is no profit or loss (Rs. 90,000 – Rs. 90,000) and at 20,000 units production level, a net profit of Rs. 30,000 (Rs. 1,20,000 – Rs. 90,000) is made.

Thus, Profit = Contribution (CN) – Fixed Cost (FC). At 15,000 units production level, the company is just breaking even and so, it is called Break-Even Point (BEP) of production. At this level, the Contribution = Fixed Cost, i.e. CN = FC.

BEP can be expressed either in terms of production level that would take the venture 'No Profit - No Loss Level' or in terms of sales revenue.

i) Capacity Utilisation Indicator

Usually, Break-Even Point is expressed in terms of capacity utilisation. In other words, suppose the venture can produce a maximum of 100 tons of Product A per year which we can call the installed capacity, at what percentage of installed capacity the venture must operate to reach the Break-Even level of production? This could be found out using the below noted formula :

$$BEP = \frac{FC}{SR - VC} \times 100 = \text{.....} \%$$

where BEP = Break-Even Production Level in terms of percentage
FC = Fixed Cost per year in Rs.
VC = Variable Cost during that year
SR = Sales Revenue during that year

ii) Sales Revenue Indicator

Break-Even Point in terms of Sales Revenue could be calculated using just two figures viz., Fixed Cost and 'Profit Volume Ratio'.

One of the important ratios to watch in business, especially in Break-Even Analysis is P/V Ratio. It expresses the relation between 'Contribution' (Sales Revenue – Variable Cost) and Sales. In other words, it tells us that after meeting Variable Cost, what percentage of sales revenue is available to you to meet fixed cost and then, the extent of surplus generation.

$$\text{Thus, P / V Ratio} = \frac{\text{Contribution}}{\text{Sales}} = \frac{\text{Sales} - \text{VC}}{\text{Sales}} \text{ Or } \frac{\text{SR} - \text{VC}}{\text{SR}}$$

Suppose, the Sales Revenue per year is Rs. 4,000 and the varibale cost is Rs. 2,000 then the P/V Ratio is calculated as under :

P/V Ratio = Contribution/Sales = SR – VC/SR

$$= \frac{4000 - 2000}{4000} = \frac{1}{2} = 0.5$$

In other words half of the Sales Revenue is available to meet fixed cost.

Having understood the concept of P/V Ratio, we can now see how to calculate Break-Even Revenue using the below noted formula:

$$\text{Break-Even Sales Revenue} = \frac{\text{Fixed Cost}}{\text{P/V Ratio}} = \frac{\text{FC}}{(\text{SR} - \text{VC})/\text{SR}}$$

Illustration

With the help of illustration, let us now find out how these formula can be applied. Let us take the example of a unit manufacturing a chemical product. The below noted illustration gives details of all costs so that we can practice identifying fixed cost as well as variable cost. Before one goes through this illustration, one has to make sure that one has understood the terminology and concepts discussed so far.

I. Cost of Project

i)	Land	Rs.	10,000
ii)	Building	Rs.	99,000
iii)	Machinery	Rs.	1,01,100
iv)	Working Capital	Rs.	91,500
v)	Preliminary Pre-operative expenses	Rs.	5,000
		Rs.	3,06,600

II. Means of Financing

i)	Long-term loan from SFC	Rs.	1,57,000
ii)	Working capital loan from Bank	Rs.	64,000
iii)	Capital Subsidy	Rs.	31,000
iv)	Own Contribution	Rs.	54,600
		Rs.	3,06,600

III. Cost of Production

i)	Raw Material	Rs.	8,46,000
ii)	Power	Rs.	7,500
iii)	Fuel	Rs.	25,000
iv)	Wages	Rs.	62,000
v)	Stores and Spares	Rs.	6,000
vi)	Maintenance	Rs.	6,000
vii)	Insurance	Rs.	5,000
viii)	Miscellaneous	Rs.	5,000
ix)	Administrative Expenses	Rs.	8,000
x)	Selling Expenses	Rs.	65,000
xi)	Interest on Term Loan @ 12.5% on Rs. 1.57 lacs	Rs.	19,600
	– Interest on Working Capital Loan @ 14% on Rs. 64,000	Rs.	9,000
xii)	Depreciation (Approx.)		
	(a) On building @ 5% of Rs. 99,000	Rs.	5,000
	(b) On machinery @ 15% of Rs. 1,01,000	Rs.	15,000
	Total	Rs.	10,84,100
	Say	Rs.	10,84,000

IV. Other Information

i)	Installed capacity	= 1500 Kgs. per year on single shift basis.
ii)	Operating capacity	= 100% (for calculation purposes.)
iii)	Sales Quantity	= 1500 Kgs. valued at Rs. 850 per kg.

= Rs. 12,75,000

iv) Profit (Sales Revenue – Total Cost) = Rs. 12,75,000 – Rs. 10,84,000 = Rs. 1,91,000

From the data in the said illustration, we have to do the Break-Even Analysis. The first step for doing so is to segregate the cost components into Fixed and Variable Costs. One could notice that there are certain items like maintenance cost; cost of spares and stores; administrative expenses etc. that are neither Fixed nor Variable i.e. they can be classified as Semi-variable cost.

Right now, we will not go into such intricate analysis. In case we have to identify Semi-Variable Cost properly and accurately, we have to examine the given cost item and if it is found that it is semi-variable in nature, split the cost items into various sub-components and find out which one is Fixed and which one is Variable. What we will now do for the sake of simplicity in calculation is to divide the cost components into just two parts viz., Fixed and Variable Cost. If it is found that a particular item cannot be so classified and falls under the category of semi-variable cost, we may take 50% of that item in Fixed Cost and rest in Variable Cost. Such an approach would not mislead us since those components of the cost that contribute most to the total cost (in this illustration about 50% of the total cost is that of raw material) would be appropriately classified as FC or VC. However, in practice, it is advisable to categorise the cost properly and in case of semi-variable cost take that component which is fixed, under the title 'Fixed Cost'. The items of cost as they appear in the said illustration can be categorised as follows :

	Item	Variable Cost	Fixed Cost
1.	Raw material	Rs. 8,46,000	
2.	Power	Rs. 7,500	
3.	Fuel	Rs. 25,000	
4.	Wages		Rs. 62,000
5.	Stores & Spares	Rs. 6,000	
6.	Maintenance	Rs. 3,000	Rs. 3,000
7.	Insurance*		Rs. 5,000
8.	Miscellaneous*	Rs. 2,500	Rs. 2,500
9.	Administrative Expenses*	Rs. 4,000	Rs. 4,000
10.	Selling Expenses	Rs. 65,000	
11.	Interest on term loan		Rs. 19,600
12.	Interest on Working Capital	Rs. 9,000	
13.	Depreciation on Bldg. & Machinery		Rs. 20,000
	Total	Rs. 9,68,000	Rs. 1,16,100

It could be noticed that 3 items of cost 'star marked' are semi-variables and for simplicity in calculation 50% of the amount has been taken as Fixed Cost and the rest as Variable Cost. For example, in this case, wages are taken as Fixed Cost because the job calls for skill and skilled labour cannot be thrown out just because the production goes down from 1500 kgs. to 1200 kgs. or so per year. So, the categorisation indicated above cannot and should not be considered as universally applicable.

As could be seen from the above statement total Fixed Cost of Rs. 1,16,000 (approx.) and Variable Cost is Rs. 9,68,000. As a check, when we add both the figures, the sum total must be equal to the total cost as it appears in Serial No. III above. Now, with the following data, let us do the necessary BEP calculations using the methodology described above.

Fixed Cost (FC) = Rs. 1,16,000
Variable Cost (VC) = Rs. 9,68,000
Selling price (SP) = Rs. 850 per kg.
Production at full capacity = 1,500 kgs. per year
Sales Revenue (SR) = Rs. 12,75,000

Contribution = SR – VC	=	Rs. 12,75,000 – Rs. 9,68,000
	=	Rs. 3,07,000
Break-even Production Level	=	FC/Contribution × 100
	=	Rs. 1,16,000 ÷ Rs. 3,07,000 × 100
	=	37.78%

This means that when the production reaches 37:78% of the installed capacity (full capacity) the venture will reach the level where there is neither profit nor loss.
Let us now see how to check the calculation:

Installed capacity = 1500 kgs. per year

Break-even Point = 37.78%

Therefore, Production level = $1500 \times \frac{37.78}{100}$ = 566.7 kgs. Approx.

We have noted that the contribution is Rs. 3,07,000

Contribution per kg. of output = $\frac{\text{Rs. } 3,07,000}{1500} = 204.67$

It means that for every kg. of output a surplus of Rs. 204.67 is generated to cover the fixed cost. Now at Break-even Production level of 566.7 kgs., the contribution is 566.7 kgs. × Rs. 204.67 per kg.

= Rs. 1,15,986

Say = Rs. 1,16,000

This means that at a Break-even production level of 556.7 kgs. after covering all variable costs, a surplus of Rs. 1,16,000 remains to cover the Fixed Cost.

By now one would have already realised that the calculations are right. However, let us see the below noted calculations

Profit = SR – VC – FC = Contribution – FC

At a production level of 567 kgs.

Profit = Rs. 1,16,000 – Rs. 1,16,000 = 0

Let us now try to calculate the Break-even Sales Revenue:

$$\text{Break-even Sales} = \frac{\text{FC}}{\text{P/V Ratio}}$$

$$\text{P/V Ratio} = \frac{\text{Contribution}}{\text{Sales}} = \frac{\text{SR} - \text{VC}}{\text{SR}}$$

$$= \frac{12,75,000 - 9,68,000}{12,75,000} = 0.24$$

$$\text{Break-even Sales Revenue} = \frac{1,16,000}{0.24} = 4,83,300$$

Thus, when the Sales Revenue reaches the level of Rs. 4,83,300 then the venture neither make profit nor loss. This calculation can be checked for its accuracy like the one we did to calculate the Break-even production level. However, if one has understood the concepts of Break-even Point and P/V Ratio discussed so far, one should be in a position to check the calculation oneself.

While it is not necessary to present the details of the calculation of BEP, as a part of the business plan document, it is necessary to provide details breakup of fixed costs and variable costs and indicate BEP in terms of capacity utilisation as also sales revenue level.

Activity 9

How would you use break-even analysis to judge the profitability of the following ventures

(a) retail trade in stationary

(b) establishment offering photocopying and fax services

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8.14 IMPLEMENTATION SCHEDULE

It is essential to draw an implementation Schedule or a time-table for your enterprise. The task of preparing such a schedule forces you

- to enumerate the various steps which you will have to take prior to commencement of commercial production.
- to appreciate the inter-dependence among these steps and hence the chain-effect of delay in carrying out one step on overall implementation schedule.
- to work out a calendar for bringing in your own funds for implementation.

Implementation schedule is an aid to ensure timely implementation of your plan. Timely implementation is important because if there is a delay, it causes, among other things, a project cost overrun. A project meant to be implemented in 12 months at a cost of Rs. 15 lacs may entail an expenditure of Rs. 20 lacs, if there is a delay in implementation and this may jeopardise the financial viability of the project itself. Hence, the need to draw up a schedule and more importantly, to adhere to it.

You will recall that project cost computation includes interest during construction period. The amount of such interest depends on your schedule for drawal of term-loan funds which in turn is tied up with your implementation progress. Thus, implementation schedule is required to arrive at an estimate of interest during construction period.

Major Considerations For Formulating Implementation Schedule

While working out implementation schedule, bear in mind the following:

- You will like to carry out tasks involving capital expenditure only after the term-loan is sanctioned.
- Some tasks are sequential. For example, machinery can be installed only after it is received. Some tasks are not sequential and can be carried out simultaneously e.g. electrification of factory building and recruitment of manpower.
- Remember, implementation progress is not entirely in your hands. An unhelpful official can hold up your term-loan sanction. A transport strike may delay delivery of machinery by a few weeks. A state financial institution may claim that a loan is sanctioned in $1\frac{1}{2}$ months, but enquiries with loanees may reveal that in most cases, it takes 3 months. It this is so, provide for 3 months. It is, thus, important to work out a realistic schedule and to build a sufficient margin of safety.

Implementation Schedule: An Illustration

Let us look at a typical, simple implementation schedule for a small project. (Statement is given below.)

This is a simplified overall schedule. It is possible to break this up into scores of specific tasks. An interested entrepreneur can use Project Evaluation and Review Technique (PERT)/ Critical Path Method (CPM) to gain better insights into all implementation-related operations and to ensure a closer monitoring of implementation progress.

Implementation Schedule: an Illustration

Task / Month	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Study of business plan															
2. Submission of term-loan application															
3. Term-loan sanction															
4. Negotiations and securing possession of land															
5. Building construction															

Task	Month	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
6. Tie-up with supply utilities (power, water)																
7. Placing order for machinery																
8. Receipt & Installation of machinery																
9. Recruitment of key manpower																
10. Trial Production																
11. Commencement of commercial production																

8.15 COMMON ERRORS IN BUSINESS PLAN FORMULATION

We have covered the ways in which you should go about working on various facets of a business plan. If you work accordingly, you are likely to avoid major errors. However, there are some errors which are so widely noticed that we, though it amounts to repetition, have chosen to highlight here:

Capacity-Utilization Estimates: Gross Unrealism
Over-optimistic and simplistic assumption with reference to utilization of installed capacity is a pervasive feature of business plans. There are so many entrepreneurs who presume 80% capacity-utilization in the first year, 90% in the second year and 100% in the third year. The assumption is made in complete disregard of exising enterprise-performance, market conditions, competition-level and possible technical snags. The business plan, in such a case, is reduced to financial jugglery. It is exciting to make such an assumption and derive satisfaction from financial-performance projection. But then, the projection is based on a completely false premises. Avoid this temptation.

Capacity Computation: A Miscalculation
The computation of installed capacity is a technical task not always performed competently. There are several finer points—die-changing time, down time, periodic shut-down, capacity of other equipments—which tend to lower the overall installed capacity. An exaggerated statement of overall capacity on account of entrepreneur being unaware of such finer points is rather commonplace. So, pay attention to capacity-calculation.

Market Study: A Neglected Task
Market study continues to be a grey area. It is relatively easy to work out technical arrangement and to make financial-performance projection. You are, in these cases, dealing with specific or quantiable variables. Market study, in contrast, entails a less structured probe and contending with less definite variables. So, there are entrepreneurs who pass by this component of business plan completely. They cite demographic (population, income, etc.) statistics, present sketchy and inaccurate information on demand-supply position, produce stray opinions and conclude that market is just there waiting to be tapped. This is an attitudinal block. Make sure you do not develop such a block.

Machinery Selection: Serious Errors
This is a subject on which faulty decisions are common. There are machinery-suppliers who may never have made a certain kind of machinery, may not have ability to do so and yet undertake to supply such machinery. The results are sometimes disastrous. There are plastic extruders which can scarcely extrude. These are being sold and bought by entrepreneurs. A small entrepreneur does not have the resources to replace or rectify the machinery. So, take care that you choose sound machines.

Technology-Oriented Products: A Shaky Arrangement
There are products which call for sophisticated technology or are not amenable to being produced in the small-scale sector. The entrepreneur is swayed by reported profit margins. He relies on a technician who may have worked in comparable enterprise but does not have the capability to line-up complete technology. Alternatively, it is not possible to set up

enterprise within stipulated financial resources. In other words, the technical feasibility is not there. The enterprise is fore-doomed to failure.

Project-Pruning and Resource-straining: Safe Limits Exceeded

You have a certain amount of money to invest. You are not in a position to exceed a pre-determined financial limit. This is understandable. However, there is an entrepreneurial tendency to accommodate enterprise-parameters within such limit, even if it is not possible to do so. Thus, an entrepreneur may cut down built-up area or exclude some machinery to keep the project cost down—within his own financial limit. He may make most favourable assumption on means of finance (75% of project cost to come as term-loan) while some amount of economy or optimism may be in order, this is sometimes carried out to such extreme lengths as to render the enterprise-proposal technically unviable (because important facilities are missing) or unrealistic (in terms of proposed financial resource plan). It is better not to pursue such an enterprise-idea. So, do not distort technical viability or pin your hope on the best deal from financial institutions to fit the proposal within resources at your disposal.

Project Cost: An Underestimate

The promoters of very small enterprises do not consider P & P expenses and working capital margin. They, consequently, underestimate the project cost and own resource requirement (margin). The others tend to play down magnitude of working capital margin. This is because if the working capital margin is large, financial institution will expect the entrepreneur to raise his own contribution to project cost. Thus working capital underestimates an error you must guard against.

Location Selection: Some Temptations

There are two major errors which an entrepreneur makes in respect of location-selection. First, he is so completely swayed by the offer of financial incentives (subsidy, income-tax concession) that he does not look into other criteria for location-selection. This sometimes becomes the sole and overriding concern. He may thus choose a location which from the standpoint of market-proximity, raw material availability, manpower position and operating cost-structure, is eminently suitable. Then, there are instances of an entrepreneur choosing a location merely because it is his hometown or he owns ancestral land—though it is not an appropriate location. Do not fall prey to these temptations. If you are selecting a location, take a comprehensive view.

Selling Price: Unfounded Optimism

A new enterprise, despite offering comparable quality, may not be able to realise the selling price which established enterprises do. The fact is overlooked. Worse still, entrepreneurs assume a higher than prevailing price because they believe the quality of their product will be superior. An unrealistic selling price estimate is an error. It is comforting to assume such a price since it will make the enterprise look very profitable. The comfort may be shortlived. So, follow a conservative path while estimating selling price.

Cashflow in Initial Years: Poor Detail

The cashflow during implementation period and initial years is not charted out in sufficient detail. You will be able to do this only if you ascertain the disbursement modalities of financial institutions completely and work out a thorough cash-plan with built-in contingencies. They may expect you to spend from your own resources in the first place. It may make direct payment to machinery supplier and reduce your flexibility. There are machinery suppliers and others who may expect advance payments from you. If you have not envisaged such payments under your cashplan, your implementation will grind to a halt.

Activity 10

From the sample you talked to for Activity 5 collect information on their experiences about the probable errors that can be made in developing the project plan.

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8.16 SUMMARY

The business plan is a blue-print of activities that an organisation proposes to engage in. Besides being a guidefrost for activities it is an essential exercise required for the purposes of developing cost and profit estimates, resource planning and feasibility testing. The project report is one of the important documents needed for the purposes of obtaining external financing from commercial banks and other financial insitutions.

This unit provides an overview of the information needed and the sequence of activities needed to be carried out in order to prepare project report. Common errors in project planning are also discussed.

8.17 SELF-ASSESSMENT QUESTIONS

1 What is the need and significance of the preparation of a project report for a small scale entrepreneur? Discuss with the help of examples.

2 Give an overview of the project preparation process.

3 What are the important infrastructure consideration that you should keep in mind before deciding upon the site of your plant?

4 How would you plan for the technology input needed in your small enterprise?

5 What are the main project cost components for which of these courses would a commercial bank offer financial assistance?

6 Explain the utility of break-even analysis for judging the profitability of small enterprises, with the help of an example.

7 Describe the common errors in project report formulation.

8.18 FURTHER READINGS

Richand M. Hodgills, "*Effective Small Business Management*, Academic Press Incorporated, Harcout, Brace Jovanovich.

UNIT 9 OWNERSHIP STRUCTURES AND ORGANISATIONAL FRAMEWORK

Objectives

After going through this unit you should be able to:

- Describe the different organisation alternatives open to you
- Distinguish between a proprietorship, a partnership and a company
- Explain the relative advantages and disadvantages of these legal forms
- Outline the important considerations in the selection of an appropriate organisational form.

Structure

9.1 INTRODUCTION

In the earlier units you have studied about environmental scanning. Opportunity appraisal and preparation of the business plan for your enterprise. Integral to all these steps is the decision to choose upon the legal form of organisation within the framework of which your plan to carry out your activities. This unit describes the various forms of business organisation, their comparative advantages and disadvantages, the tax structure associated with each form as well as the criterion that govern the choice of a particular form of business organisation.

9.2 FORMS OF BUSINESS ORGANISATION

As an entrepreneur, you wish to have a business of your own, but at the initial stage you are usually neither bothered nor keen to know what the legal and other aspects of the forms of a business enterprise are. But you can not postpone this decision for long because if you wish to raise a loan, your banker would like to know about the form of organisation you have found. If you require a good team of employees, they might like to know about it and so on. So before you abruptly take a decision to opt for one or the other form of ownership of business, let us understand the various options. Your decision has to be very caution because every form has its inherent advantages and disadvantages, limitations, attendent risk and manner of operation. Further, your decision about choosing a specific form of ownership is guided by various factors such as :

i) your personal capacity to take decisions, manage and control particular situations,

ii) your capacity to cover risk,

iii) your professional background which includes your educational background, technical expertise and experience or expertise in manufacture of proposed product, and

iv) your capacity to invest in your dream enterprise.

Harendra Agarwal before going in for his chemical manufacturing business was curious to know from his Chartered Accountant as to why a formal organisation is needed. His

Chartered Accountant satisfied him by telling that any activity done by an entrepreneur has a definite objective, which is a step towards his target, which in turn needs an organisation in one form or the other. Consequently any business activity in order to be coordinated and managed needs to be organised in a formal pattern of relationship relating to ownership and control.

Further, at your desire you are free to change the form of ownership chosen. If you started your business as sole proprietorship, you may convert it to partnership or to a company, or vice-versa, whenever you want. Your options are confined to the following forms of ownership:

(i) Individual Proprietorship
(ii) Partnership-Joint family business
(iii) Partnership with others
(iv) Private limited company
(v) Public limited company
(vi) Co-operative society

Activity 1
Talk to some entrepreneurs about to set up their own business. What is the form of business organisation they have in mind? Describe two important reasons they cite for choosing the desired form.

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Let us understand what each of these options offer?

9.3 PROPRIETORSHIP

You are master of your show. In a proprietorship the enterprise is owned and controlled only by one person. Here a single person sows, reaps and harvests the output of his labour. Of course there are his relatives, friends, family, financial institutions, Government and his employees to assist him. This form is one of the most popular forms in India and the reason for its being so popular is, the advantages it offers.

Akhilesh Das of Continental Enterprises preferred a sole proprietorship because his business was going to be very small and the degree of risk involved, not very high. Ravi Bhushan preferred this form of ownership for his business because it does not require legal recognition and attendent formalities. In this form of ownership, business can be started simply after obtaining necessary manufacturing license and permits.

9.4 PARTNERSHIP

When the quantum of business is expected to be moderate and the entrepreneur desires that the risk involved in the operation be shared, he may prefer a partnership. Swatantra Rastogi and Shashi, when they started a business of road construction preferred a partnership because one of them had experience of road construction and the other had money. In India the law relating to the partnerships is given in the Indian Partnership Act, 1930. A partnership comes into existence when two or more persons agree to share the profits of a business, which they run together. This business may be carried on by all or by any of them acting for all. Those who thus enter into an agreement are individually called as 'partners' and collectively they are called as firm. The name under which their business is carried on is called the 'Firm name'. Some say that firm is nothing but an abbreviation for partners. The characteristics of a partnership are:

(i) Partnership is the outcome of a voluntary agreement between the persons, who after the agreement has been arrived at, would be known as partners. Therefore, a partnership cannot come into existence by a law or by status and a partnership agreement should have all the essentials of a valid contract.

ii) A relation of partnership can be entered into between persons only. Maximum number of members that a firm may have is twenty but if the agreement is to carry on banking activities, not more than ten persons can be a partner in such a firm. A partnership become illegal if it includes more than stipulated number of persons.

Although it is left to the choice of the partners to decide as to what should be mentioned in their partnership agreement but usually following matters are spelled out in the agreement:

1. The object and duration of partnership
2. The duties of pertners
3. The right of partners
4. How the losses and profits of the business shall be divided
5. Procedure to be followed when any partner wishes to withdraw from the partnership or a new partner enters the business
6. Manner in which any controversies that arise out of the partnership agreement will be settled.

In order to appreciate a partnership we should distinguish it from certain non-contractual, quasi-partnership relationships, which may be created on account of specific customs of personal law. The members of a Hindu undivided family carrying on a family business as such, or a Budhist husband and wife carrying on business as such, are not partners in such business. These relationships do not come into existence owing to a voluntary agreement amongst them and are therefore not partnership but "joint ownership". The contract by which the partnership is created may be express or implied. It is express when it is in writing or is created by words of mouth; it is implied when it is to be inferred from the conduct of the parties or from the circumstances of the case. But in view of the disadvantages suffered by a unregistered firm it is in your interest that the partnership agreement should be drawn in the beginning and signed by all of you, who have agreed to enter into a partnership. It is advisable even when you are intending to commence the relationship with your wife. The losses are a fact of business life. The partners are free to provide in their partnership agreement that one or more than one of them will not be responsible to the losses of the business.

(iii) Another characteristic of a partnership is sharing of profits of business amongst the partners. Unless specifically mentioned, all partners are supposed to share the profits and losses of the business in equal share. Sharing of profits is a hallmark of a partnership but everyone who takes share in profit does not thereby becomes a partner. The receipt of such share or payment—by a lender of money to persons engaged or about to engage in any business or by a servant or agent as remuneration or by the widow (or child) of a deceased partner as annuity or by a previous owner of past owner of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner of the persons carrying on the business.

(iv) The business of partnership may be carried on by all the partners or it may be carried on by any one of them acting for all. This element of partnership—mutual agency—shows that the persons of the group who manages the business do so as agents for all the persons in the group, are bound by their acts and liable to account for all.

After knowing the essential characteristics of partnership let us remember that a partnership may be created for a fixed period only or even for execution of a particular venture. It is a fundamental feature of partnership that every partner has an option to withdraw from the partnership at anytime, after complying with the formalities stipulated in the Act and in the partnership agreement.

A natural query at this stage may be—Can a minor become a partner? The answer is no, but with the consent of all the partners, the minor may be admitted to the partnership to share the profits of the business, carried on by them. Such a minor has the right to such share of the property and of such profits of the firm as may be agreed upon, the point to remember is that the minor is not personally liable for the losses of the business, only his share in the partnership business is liable for the acts of the firm. When such minor attains majority or when he obtains knowledge that while he was a minor was admitted to the benefits of partnership, which ever date is earlier, within six months of such date, such person is required to decide whether he elects to become or not to become a partner, in the firm. Such election shall determine his position as regards the firm. If he decides to become a partner his rights and liabilities continue from the date on which he becomes a partner and he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

If he elects not to become a partner in that situation his rights and liabilities shall continue to be those of a minor upto the date on which he gives public notice of his intention of not continuing his relationship with the firm.

Duties of partners

Partners are free, of course, subject to the provisions of the Partnership Act, to agree upon their mutual rights and duties. This agreement is not immutable and the terms of the agreement may be varied by consent of all the partners. Usually the partners agree to the following duties :

(1) that any partner shall not carry on any business other than that of the firm while he is a partner;

(2) that the partner will attend to his duties diligently in the conduct of the business;

(3) that he shall indemnity the firm for any loss caused to it by his fraud or wilful neglect in the conduct of the business;

(4) that he shall not derive any profit for himself from any transaction of the firm or from the use of the property or business connection of the firm or the firm name;

(5) that he will be liable jointly with all other partners and also severally for all the acts of the firm done while he is a partner;

(6) that he will remain just and faithfull to other partners and will render true accounts and full information of all things affecting the firm to any partner of his legal representative.

Rights of partners

As the partners are free to decide their duties, they are likewise free to decide by contract between themselves their mutual rights. Usually a partnership agreement guarantees the following rights to every partner :

(i) that every partner is entitled to take part in the conduct of the business;

(ii) that every partner has a right to have access to and to inspect and copy any of the books of the firm;

(iii) that every partner is entitled to share in the profits earned;

(iv) that every partner has a right to be indemnified in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business;

(v) that every partner has a right to be consulted and heard before any decision is taken in relation to any matter concerning the firm;

(vi) that if any partner makes for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon.

Activity 2

Discuss with 2 small partnership to find out

(a) How have the objects of partnership been defined?

(b) How are the rights of partners defined?

(c) What is the profit sharing ratio of these partners ?

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Registration of Fi...

The law relating to registration of firms is very interesting. While it is not compulsory for a firm to get itself registered but it becomes highly desirable for firms to get themselves registered, because of the limitation, unregistered firm has to face.

For the purposes of registration the State Government appoints a Registrar. When you want to get your firm registered you may send your application to the Registrar of Firms along with prescribed fee. This application may be sent by post or may be delivered in person to the Registrar of the Area in which the place of the business of the firm is situated or proposed to be situated.

The application has to be in the form of a statement which should indicate

(a) The firm-name,

(b) the place or principal place of business of the firm,

(c) the names of any other place where the firm carries on business,

(d) the date when each partner joined the firm,

(e) the names in full and permanent addresses of the partners, and

(f) the duration of the firm.

This statement should then be signed either by the partner or by their agent specially authorised in this behalf. After affixing their signatures, these signatures have got to be verified. When the Registrar is satisfied that all formalities relating to registration have been properly complied with, he shall make suitable entries in a register known as Register of Firms and shall issue a certificate of registration.

In order to fully appreciate this part, you should know the effect of non-registration of a firm. If a firm is not registered,

(1) No suit to enforce a right arising from a contract or conferred by this Act shall be instituted in any court or on behalf of any person such as a partner. Such a suit can neither be instituted against the firm nor against any co-partner including a past co-partner.

(2) No suit to enforce a right arising from a contract can be instituted by or on behalf of a firm against any third party.

(3) Neither the firm nor any partner is competent to make a claim of set off or other proceedings based upon a contract.

However this disability does not restrain the third parties to sue the firm or any partner for the enforcement of their rights.

1. Dissolution of Firm

If one or more than one partners leaves the firm and other partners continue the firm, it is called dissolution of partnership but when all and each one of the partners ceases to carry on the business and decides to separate, it is dissolution of the firm. Strictly speaking, the dissolution of partnership between all the partners of a firm is called the "dissolution of the firm". A firm may be dissolved with the intervention of the court or without the intervention of the court. Following are the ways in which a firm may be dissolved :

(1) with the consent of all the partners or in accordance with a contract between the partners: since a partnership is created by a contract, it can be dissolved by a contract. At anytime during the firms life, all partners may decide to dissolve it or may dissolve it in accordance with a contract already made in the partnership agreement. Mohit Kumar and Ajay Kumar are partners in a firm. The partnership deed provides that the firm can be dissolved only by mutual agreement. Mohit Kumar wants to dissolve the firm. He cannot compel Ajay Kumar to dissolve the partnership.

The situation would be different of the partnership is Partnership at will. In such a case the firm may be dissolved by any partner giving notice in writing to all the other partners. The firm in such a case shall stand dissolved from the date of notice. If no date is given in the notice the dissolution will be effective from the date of the communication of the notice.

2. Compulsory dissolution

Under any of the following circumstances a firm is dissolved :

(a) by the adjudication of all the partners or of all the partners but one as insolvent, or

(b) by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership.

M/s. Rainbow Financiers which has twelve partners are carrying on business of financing automobiles. The Parliament passes an Act which makes it unlawful for any firm having more than ten partners, to carry as such business. The partnership is dissolved.

However, if the firm carries on many separate undertakings or adventures, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

3. Dissolution on the happening of certain contingencies

If the partners so agree a firm is dissolved

(a) if constituted for a fixed term, by the expiry of that term;

(b) if constituted to carry out one or more adventures or undertakings, by completion thereof;

(c) by the death of a partner; and

(d) by the adjudication of a partner as insolvent.

4. Dissolution by Court

Under any of the following circumstances any partner may present a petition before the Court for the dissolution of the firm, whereupon the court may dissolve the firm, when

(a) any partner has became of unsound mind;

(b) any other partner has became in any way permanently incapable of performing his duties as partner;

(c) any other parmer is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business;

(d) any other partner wilfully or persistently commits breach of agreement relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him;

(e) any other partner has transferred the whole of his interest in the firm to a third party, or has allowed his share to be attached or to be sold in the recovery of arrears of land-revenue or of any dues recoverable as arrears of land-revenue due by the partner;

(f) the business of the firm cannot be carried on save at a loss; or

(g) there exists any other reasonable ground which renders it just and equitable that the firm should be dissolved.

Activity 3

Partnership has a temporary existence in that it can be dissolved with comparative ease. From 5 entrepreneurs who have had experience of running partnerships earlier find out and describe

(a) What are the most common reasons for dissolution?

(b) Do you think these causes can somehow be taken care of, to make the existence of this firm more stable?

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9.5 COMPANY

Besides partnership, which is a very common form of organisation among small entrepreneurs, another form of ownership that you should know about is a Company. The law relating to companies in India is contained the Companies Act of 1956.

Let us know what a Company is? A company may be understood as an association of persons in which money is contributed by them, to carry on some business or undertaking. Persons who contribute the money are called the shareholders or the members of the company. Given below are the characteristics of a company:

(a) **Artificial legal person :** As soon as an association of people gets incorporated as a company, assumes the identity of an artificial person. Since the company after incorporation, in the eyes of law is treated as a person, the company may sue or be sued by its members/shareholders whenever any breach of their rights or duties is committed. As a person the company can enter into contracts in its own name and likewise may sue and be sued in its own name.

(b) **Separate legal entity :** As is apparent from the above description after registration the company acquires a personality of its own which is distinct and different from the personality of the members/shareholders constituting the company. Although an independent person yet the company can neither think, nor do anything by itself, therefore its affairs are managed by a Board of Directors, who manages the affairs of the company on behalf of the company and in accordance with its Memorandum and Articles of Association.

(c) **Common Seal :** A company, being a natural person acts through natural persons (directors and other authorised managerial personnels of the company). Hence when any contract is entered in the name of the company, the company's seal is required to be put on the same, in order to make the contract binding on the company.

(d) **Perpetual existence :** The company being a creation of law is not effected by the joining, leaving, death, insolvency or insanity of any of its shareholders. Since the company enjoys a separate legal existence from that of its members, any variation in the number or identity of its members does not affect the corporate existence and corporate identity. It is rightly said "members may come, members may go but the company goes for ever". Further since a company comes into existence only through a process of law, it can only be dissolved through a process prescribed by law.

(e) **Transferability of shares :** The shares of a Joint Stock company (except private company) are freely transferable. A private company through its articles places certain restrictions on the transferability of its shares. For all other joint stock companies members owing fully paid up shares can freely transfer their shares at a stock exchange or through agreements entirely on their own discretion but subject to the rules of the company. Any absolute restriction on the transfer of shares of the company is however avoided.

(f) **Limited liability of members :** This characteristic emerges as one of the major advantages of this form of organisation. In case of a company limited by share, the liability of the members of the company is limited to the nominal value of shares held by them. In case of a company limited by guarantee, members are liable only to the extent of the amount guaranteed by them.

An incorporated company is a corporate body and by fiction of law it is treated as a legal person. This means that a company has a personality of its own. The company thus has a independent status which is different from the status of the members/shareholders constituting it. Consider this example. Ajay Kumar, Arun Kumar, Mohit Kumar and Sadhna form a company and get it registered in the name of Mitter Kumar Pvt. Ltd. Once the company is registered this company Mitter Kumar Private Ltd. will be regarded as a person and as such would have an independent personality different from the personality of Ajay Kumar, Arun Kumar, Mohit Kumar and Sadhna.

Activity 4

State whether the following statements are true or false?

(a) Under law the company is treated as a separate person ☐

(b) The property of the members of the company is separate from that of the company ☐

(c) The shares of every type of company are freely transferable ☐

(d) The death of all the members of a company would affect the existence of the company ☐

(e) The members of a company have only limited liability ☐

(f) The company cannot sue in its own name ☐

Depending upon the type of restrictions you want to impose upon your organisation, you may form a

(i) Private Company, or a

(ii) Public Company.

Under Section 3(i) (iii) of the Companies Act, a Private company has been defined as a company which by its Articles of Association

a) restricts the right to transfer the shares, if any,

b) limits the number of its members to fifty, and

c) prohibits any invitation to the public to subscribe for the shares or the debentures of the company.

A public company by definition Sec. 3(i) (iv) is a company which is not a private company. By implication, therefore public company is one, registered under the Companies Act which places no restriction by its Articles of Association on the transfer of shares or on the maximum number of members/shareholders and can invite the public to subscribe for its shares debentures and public deposits. You must understand that these provisions also mean that any member of the public who is willing to pay the price may acquire shares and debentures of your company. This has interesting implications for dilution of ownership and control which you may like to consider before deciding upon the organisational form. The distinction between a private company and a public company have been detailed out in Table 1 below:

Table-1

		Public Company	Private company
1.	Formation		
		a) At least seven members are required	a) At least two members are required
		b) Formation is difficult because it requires many formalities such as consent of the directors, copy of contract to acquire qualification share within stipulated time, has to be filled with the Registrar of companies. Before such company can commence business it should obtain certificate of Incorporation as Certificate of Commencement of business.	b) Formation is simpler. Documents relating to directors' acquiring qualification share are not required to be submitted to the Registrar of Companies, nor director's consent to act as director is needed. Such company can commence its business soon after obtaining certificate of Incorporation.
		c) Minimum number of directors needed is three.	c) Minimum number of directors needed is two.

			Public Company		Private company
		d)	Minimum number of members needed is seven.	d)	Minimum number of members needed is two.
		e)	No restriction on the maximum number of members	e)	Maximum number of members cannot exceed fifty.
2.	Prospectus	a)	Filing of prospectus or a statement in lieu of prospectus with the Registrar of Companies is necessary before company can allot shares.	a)	Not needed
3.	Documents	a)	Seven members have to sign the memorandum and articles of association.	a)	Only two members need to sign the documents
		b)	If need not prepare articles if it chooses to adopt table A of the Companies Act as its articles of association.	b)	Articles of association have to be compulsorily framed as the company places certain restrictions on itself through the provisions of its articles.
4.	Allotment of shares	a)	Shares cannot be allotted 'till the amount of maximum subscription in cash has been received.	a)	No such restriction is applicable
		b)	can issue only equity and preference shares	b)	can issue both equity and preference shares as well as sharewith disproportionate voting rights
		c)	Invitation to public to subscribe for the shares, debentures or public deposits can be made through prospectus.	c)	no such public invitation can be made
5.	Transfer of shares	a)	Shares are freely transferable and can be quoted on the stock exchange	a)	Transfer of shares restricted by the articles therefore shares cannot be quoted at the stock Exchange.
		b)	Company can issue bearer share warrant.	b)	Such warrant cannot be issued.
6.	Directors	a)	Law places restrictions on the remuneration payable to directors	a)	No such restrictions applies
		b)	Directors are subject to retirement by rotation	b)	Directors are not liable to retire by rotation.
		c)	Loans to directors cannot be sanctioned without approval of the Central Government.	c)	Directors can borrow from their company without the approval of the Central Government
		d)	Any director having an interest in any subject matter of the meeting can not participate and vote on the issue.	d)	Interested director can participate as well as vote
7.	Statutory meeting	a)	Company must hold a statutory meeting and file a statutory report with the Registrar of Companies within six months from the date of obtaining the certificate of commencement of business.	a)	No such restriction applies.

In view of the restrictions discussed in relation to the private company you may think that it may not be a very preferred form of ownership. On the contrary a substantial number of entrepreneurs prefer to form a private company; as the private company has been granted several privileges under the Companies Act. Some important privileges among those are:

a) For forming a private company only two members are required.

b) Such company may commence business immediately after incorporation.

c) A private company is not required to hold a statutory meeting nor is it required to file a statutory report.

d) Such company may issue any kinds of shares and allow disproportionate voting rights.

e) A private company need not file a prospectus or a statement in lieu of prospectus, to the Registrar of company.

f) The directors of a private company are not required to file their consent to act or to take up their qualification shares prior to their appointment.

g) The directors of a private company are entitled to vote on a contract in which they are interested.

h) A non-member can not inspect the copies of profit and loss account filed with the Registrar of Company.

i) Limits imposed by Section 309 of the Act, on payment of maximum managerial remunerations are not applicable.

j) Restrictions on the appointment and reappointment of managing director are not applicable.

Activity 5

What in your opinion is a more suitable form of company for a small enterprise—a private or a public company? Discuss with entrepreneurs managing both these types of concerns, to explain their views on the suitability of public vs. private company form?

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In case of both private and public companies, on the basis of liability of members, companies can be classified as:

a) Company limited by share
b) Company limited by guarantee
c) Unlimited company.

Company limited by share is a registered company in which the liability of members is limited to the amount remaining unpaid on the shares held by them.

Company limited by guarantee means a company in which each member is liable, in the event of liquidation, to pay a specified sum of money, guaranteed by him. If the guarantee company has share capital also, the members have two fold liability; to pay the amount which remains unpaid on their shares, whenever called upon to pay and secondly to pay the amount payable under the guarantee when the company goes into liquidation. The voting power is a guarantee company is determined by the shareholding and not by the guarantee. An unlimited company (Section 12(2-C) is a company not having any limit on the liability of its members. In the event of the winding up of the company, the liability of the members may reach upto the limits of their personal assets, to meet the obligations of the company. Such companies may or may not have share capital. It may interest you to know that the company law recognises some more classes of companies, important among them are

(a) Government company
(b) Foreign company
(c) Holding and subsidiary company.

A Government company is one in which "not less than 51% of the paid up share capital is held by the Central Government or by any State Government or Governments or partly by Central Government and partly by one or more State Governments. Indian Telephone Industry, Hindustan Machine Tools, and Hindustan Aeronautics Limited are examples of a Government company.

A foreign company is a company which is incorporated in a country outside India under the law of that country but has established a place of business in India. Some of the provisions of the Indian companies Act are applicable to such companies. A foreign company may be either a private company or a public company.

A holding company is one which has another company as its subsidiary. According to section 4 of the Companies Act, a company shall be deemed to be subsidiary of company B if and only if

(i) company B (holding company) controls the composition of the Board of Directors of Company A (subsidiary) or

(ii) Company B (holding company) controls more than 90% voting powers of company A (subsidiary) or

(iii) if company A is a subsidiary of company C which is itself the subsidiary of the company B

Formation of a company

As you must have earlier noted a company comes into existence only after registration. For registration the following documents need to be filed with the Registrar of the companies of the State in which the company wants to have its registerd office.

(i) **Memorandum of Association :** It is a document originally created for every company which governs the area of operation and the relations of the company with the third parties. It mentions the name of the company, place of its registered office, object/objects of the company and lays down provisions regarding its capital and the liability of its members, shareholders and lastly a declaration by the members of the company and they have associated to form a company and that all the necessary formalities have been complied with.

(ii) **Articles of Association :** It is another document consisting of regulations for all aspects of the internal management of the affairs of the company like the rights of members, conduct of meeting, appointment and removal of directors etc.

(iii) A list of persons who have given their consent to be the first directors of the company (Applicable in case only of a public company).

(iv) A written undertaking by each of the proposed director to accept and pay for their qualification shares, if any (Applicable only in case of a public company).

(v) A statutory declaration, by a Chartered Accountant as director of Company or an Advocate or the secretary or a person who is named alongwith the required registration fee and the stamp duty, declaring that all the legal requirements of the companies Act in respect of formation of the company have been complied with. As the company has not yet come into existence, the preparation of these documents and fulfilment of the attendent formalities are undertaken by a group of individuals, an individual interested in the formation of the company called the promoter of the company.

After being satisfied that all the documents are in order and all the formalities relating to registration of a company have been complied with, the Registrar of Companies would register the company and would issue a certificate of Registration of the company. A private company can commence its business after obtaining this certificate. But a public company cannot commence its business unless it has obtained yet another certificate from the Registrar of Companies—Certificate of Commencement of business.

Management of the Company

You have already noted that a company is managed by the system of representative management i.e. through the medium of individuals known as directors, collectively known as the Board of directors of the Board. The directors act as the brain of the Joint Stock Company. Legally their position is that of an agent of the company in some aspects and that of a trustee in some other aspects. As a trustees, in respect of the properties and powers of the company, the directors are expected act in good faith and in the interest of the company as the company with outsiders and are liable in all cases where an agent is personally liable under the law of contract. Although in matters relating to the management of the company the directors are the highest authority, legal restriclions on their powers have been put through the Memorandum and Articles of Association, the Companies Act and the general law of the land.

Winding up and dissolution of the company

Being a creation of law a company can be wound up only through a process prescribed by law. Winding up is the process by which the assets of the company are realised and used for the subsidiary of company B then company A is a subsidiary of company B. A company can be wound up by the following modes:

1. Winding up by court,
2. Voluntary winding up: } Member's voluntary winding up, Creditor's voluntary winding up.
3. Winding up under the supervision of the court.

You must be clear about the fact that even if all the members of the company or all the creditors or both agree to dissolve the company as their even they cannot do so except through a process of law as a company like partnership has not come into existence through a control between members but through a process of law.

9.6 FORMS OF OWNERSHIP—ADVANTAGES AND DISADVANTAGES OF ORGANISATIONAL FORM

Having understood the salient characteristics of different forms of business organisation, let us now assess the relative advantages and disadvantages of these forms.

The proprietorship

A sole proprietorship, as you know, is a business owned and controlled by one person and being the simplest forms of a business enterprise has several advantages such as

1. Lack of restrictions
2. Owner's enjoyment of all profits
3. Owner's freedom to take all decisions
4. Financial advantages
5. Tax advantages
6. Secrecy.

Lack of restrictions

Lack of restrictions or minimum legal restrictions is the distinguishing feature of a proprietorship concern. In a proprietorship the entrepreneur is required to file few reports and is not required to draw up legal documents to commence his business nor is he required to pay any fees to set up his business. No formal registration is statutorily needed. Most common amongst the proprietorships are the sole proprietorships i.e. one person operating the whole business.

Owner's enjoyment of all profits

One advantage of proprietorship is that the owner keeps to himself all profits of his labour. Unlike other forms of ownership, in a proprietorship, there is no other person to share his profits, which in turn is a source of great personal satisfaction to him. He may work for as many or as few hours a month, as the proprietor.

Owner's freedom to take all decisions

Another advantage of proprietorship is that the proprietor is free to make all decisions. There is no other person who can weigh him down or create administrative problems for him. In this way he may freely concentrate on his business.

Ravi Khatoo owns a nursery which employs 19 people. The nursery has been operating quite successfully during the entire period. Number of customers has increased by an average of 30 per cent per year. One factor behind his sale strategy is that he makes a discret option in offering the plants at a particular price and is not bothered about the profits. His prime object is the future business which he thinks he is likely to get from a particular person. This freedom of decision has paid good results to him.

Financial advantages

One major advantage of a proprietorship is the financial advantage involved in this form of ownership. Personal reputation and his personal assets stand behind the concern. Whenever needed the proprietor can draw upon both to augment his business resources.

Tax advantages

A proprietorship form of legal organisation has certain tax advantages which are not available to the other forms of business ownerships. Individual proprietorship income is taxed only once while corporate income is at occasion, taxed twice. Tax action with respect to all the forms of organisation is discussed separately.

Secrecy

Secrecy is another major advantage offered by proprietorship. In present day business atmosphere, the less a competitor knows about one's business, the better off one is. In proprietorship the proprietor is required to reveal very few things to others, about his operations, he can keep his business secrets to himself and the competitor can only make guesstimates regarding its sales, profit margins and overall financial strength.

Disadvantages of the Proprietorship

In spite of all the above mentioned advantages, there are some drawbacks associated with the proprietorship. In deciding whether the type of operation will suit him best for the business, the entrepreneur needs to consider such things as:

(1) Owner's probable lack of ability and experience—
The owner may truly lack requisite ability and experience to run a business enterprise of his own. Though this flaw in the entrepreneur's capability does not apply in sole proprietorship only, it could apply as well in partnership and companies. In the latter cases the lack of ability and experience may be compensated by the ability and experience of other partner/ directors. In sole proprietorship since the entire decision-making is centralised in the owner's hands this flaw may become a deblitating one.

(2) Difficulty in raising capital—The raising of capital single handed can be a problem as the owner has only his own asset and goodwill to fallback upon, abetted by the assistance provided by the financial institutions. As a generalisation one person would have less to invest to meet the capital needs of a new small business then a group of owners. If the owner does not wish to share the ownership of the business, the alternatives for raising capital for his business are rather limited.

(3) Limited life of the organisation—The life of the proprietorship depends solely on the proprietor. If he dies, becomes insolvent or permanently incapacitated or insane, the business may wind up. This has implications not only for the employees of the organisation but also for the creditors. It is this implication which finds an expression in the restrictions on credit granted to the sole proprietor. It is not uncommon to find creditors requiring the proprietor to carry life insurance sufficient to meet the financial obligations of the proprietorship.

(4) Limited size—There being only one owner of the business the amount of capital that can be raised for operation and consequently the probability of attaining a large size are limited. This is especially true since the growth of a proprietorship is to a large degree dependent upon reinvested profits. As the capital that can be raised is limited the growth of the business can also attain only a limited size. The problem of size may also have managerial ramifications. Being the only owner the proprietor is responsible for carrying out all decision-making activities and quite a few of the operational ones. This can become a burden as the business increases in size. Delegation of authority offers a solution, but the major decisions continue to be the owner's responsibility. It is then that he makes a conscious decision on whether or not to increase the size of the business enterprise any further.

(5) Unlimited liability—By far the greatest disadvantage of sole proprietorship is that of unlimited liability. The sole proprietor is personally responsible for all the debts that he incurs. The creditors having a claim on these debts can exercise it against both the business and the personal assets of the proprietor. For example of the proprietorship operation is worth Rupees 10 lakhs but the proprietor has debts of 25 lakhs. The creditors can sue the proprietor and force him to liquidate personal assets to pay the financial obligations. What this amounts to is that even though the proprietor believes that only part of his total capital is invested in the business, he is liable to the full extent of total personal assets for liabilities of his business. A damaging law suit lost, a serious accident involving injuries to employees, a critical marketing setback are some of the contingencies that can create liabilities for beyond those anticipated at the time of planning the business. The owner's personal savings, investments and all other assets become liable and may be endangered.

Advantages of the Partnership

From the point of view of evaluating it as an organisational form the following advantages of partnership must be considered :

(a) Ease of organisation—As partnership is based on mutual contract between all the partners, it is relatively ease to form. The legal formalities associated with formation are minimal, so much so that registration of a partnership firm though desirable, is not obligatory.

(b) Combined talent. Judgement and skill—The old maxim of two heads being better than one aptly applies to partnership. If these are three or four or more partners the chances that better decisions collectively will emerge are higher than in case of a proprietor operating alone. Pooling of skills, especially when each partner specialises in a different area gives the firm a competitive advantage of collective expertise.

(c) Increased sources of capital and credit—We have just seen that the sole proprietorship suffers from the limitation of limited capital because there is only one individual to invest his assets and bring in credit. A partnership can overcome this problem to a certain extent by bringing into association more people with capital to invest as well as personal assets that can be used as collateral for bank loans and other credit. The lending institutions also perceive less risk in granting credit to a partnership than to a proprietorship because the risk of loss is spread over a number of people rather than only one.

(d) Improved chances of growth—Consequent upon the increased sources of capital and credit and better decision-making potential, the partnership is in a much better position to expand and grow than a proprietorship. Being managed by a group of people, a partnership has both monetary and managerial resources to manage larger facilities and more employees. Therefore, as the operations expand in size, the owners are able to maintain effective control.

Tax advantage

From the taxation point of view partnership seems to be the most desirable form of organisation as the taxation rates applicable are lower than both the other forms in question. You will get a fuller exposure to taxation provisions relevant to these forms of organisations in—of this unit.

Disadvantages of the Partnership

Inspite of its numerous advantages the partnership also has some important disadvantages which must be seriously considered before opting for this form of organisation.

(a) Unlimited liability—As already noted, unlimited liability is an important characteristic of partnership. Just as this condition is applicable to proprietorship, it becomes an even more serious limitation in partnership. Not only is a partner liable to the extent of his personal assets, for the debts of the firm, he is also responsible to the full extent of his resources for the debts contraded by other partners. Similarly, as profits and losses are to be shared between the partners even if one partner can not come up with his share of the losses, the others will have to make up the deficits.

(b) Limited life—If any partners dies, becomes insane or is otherwise incapacitated or simply wants to withdraw from the business, the partnership gets terminated. As the number of partners increases, the probability of occurrence of these contingencies goes higher. This creates problems of continuity in business.

(c) Divided authority—We just talked about the maxim of two heads being better than one, carried to an extreme the situation may turn into "too many cooks spoils the broth". As long as each partner restricts his activities to his defined area of operation, the problems of divided authority can be checked. However, other areas like policy formulation for the whole firm, financing plans, evolving personnel policy and ideas on expansion can create possibilities for conflicting authority.

(d) Danger of personal disagreements—Being an association of people, a partnership is always open to the danger of disagreement between its members which at times may become extremely serious. Even if a partnership agreement is thoroughly detailed, clauses may be subject to different interpretations. Some partners may wilfully exceed their defined authority and discontent may develop because of diverse working styles and conflicting egos. Many successful partnership firms have been dissolved because of serious disagreement between the partners.

Advantages of a company

The important among the advantages of a company are :

(a) Limited liability—The advantage of limited liability offered by a company forms an effective incentive for choosing this form of organisation as the shareholders are fully aware that they stand to lose no more than what they have agreed to invest in the business.

(b) Perpetual existence—Continuity to the business is ensured as unlike a partnership or a proprietorship, a company enjoys perpetual succession. Death, incapacity or or insanity of the shareholders do not affect the corporate existence of the company as the shares simply get transferred to the legal heirs who can sell them further if they do not want to retain the share contingencies like insolvency of the shareholder or selling of the shares by him also do not bring the life of the company to an end. As these factors would only result in the change of ownership of shares.

(c) Transferability of shares : Ease of transfer of interest in a company represents another major advantage of companies. The very fact that you can transfer your interest anytime you want to, facilitates both investment and disinvestment decisions in this form of organisation.

(d) Expansion potential—In comparison to proprietorship and partnership, the company has far greater potential for raising capital through issue of shares. This has implications for both ease and volume of expansion.

(e) Representative management—Both proprietorship and partnership are characterised by direct management in that the owner/partners directly participate in the management of the organisation. A company on the other hand is characterised by representative management in that shareholders elect the directors to manage the company. The directors in turn manage the company as agents and trustees of the company, for the benefit of the company. If found to be deficient in performing their duties, any director may be removed. In addition to the Board of Directors, the company also relies on bringing in specialists as managers to manage the affairs of the company, which augurs well for efficiency and management.

Disadvantages of a company

a) Lack of secrecy— As the company has to make various statements available to the Registrar of Companies and Financial Institutions, there is much less confidentiality of operations as compared to the other forms of organisations. In addition, the company has to provide an annual report to every shareholder, which further reduces the degree of secrecy, as everyone including the competitors can find out details of all financial data.

b) Legalities of formation—Being a creation of law, a company involves far more legal formalities of formation in comparison to the other two forms. These includes registration and pre-registration formalities like preparation of documents entering into pre-incorporation contracts, obtaining the consent of directors and furnishing the stamp duty. All these steps considerably lessess the ease of formation characterising the other forms of organisation.

c) Legal restrictions—The operation of a company are far more regulated by the comprehensive legislation of the Companies Act. Almost all aspects of its management and operation must comply with the provisions of the Act. In addition to the Company Act, several other Acts impose restrictions on the activities of companies in India.

d) Heavy Taxation—Companies are subject to heavier taxation rates. There is also an incidence of double taxation in that after deducting tax, when the company pays dividend to its shareholders, the individual shareholders is also liable to pay personal Income tax on all dividends recovered depending upon their respective tax brackets.

Activity 6

Now that you have understood the relative advantages and disadvantages of all the forms of ownership, what kind of ownership pattern would you suggest for

(a) A person planning to form a part time service organisation who has limited capital resources.

(b) A person going in for readymade garment export trade.

Give reasons for your answer.

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9.7 TAXATION AND THE LEGAL FORMS OF ORGANISATIONS

The different forms of organisations are subject to different tax rates under the provisions of the Indian Income Tax Act 1961. Even though these provisions keep changing, it will be useful for you to have an overview of tax structure for different forms. The following section gives a brief explanation of tax structure applicable to sole proprietorship, partnership and companies.

Sole proprietorship
Under the sole proprietory form of organisation, it is not the business but the proprietory who is put to tax and it is not only the business income/loss but the total income from all the sources accruing to the proprietorship which is taxed together as one bloc. Certain incomes can accrue only to an individual such as salary. Apart from being single taxation the proprietor can set off any business losses from his other incomes and enjoy tax immunity to that extent. The proprietor may also get tax relief for institutionalised savings and investments. By institutionalised savings we mean investments made in paying the L.I.C. premium, Provident Fund/Public Provident Fund contribution etc., money spent in purchase of National Savings Certificates or paying instalments for acquiring a residential house from any public housing agency or investment in new shares etc.

As against this the major disadvantage of this form of business is disallowance of any personal expense incurred for the benefit of proprietory.

The minimum and maximum tax rates for individuals for the Assessment year 1991-92 are 20% and 50%, respectively. The basic exemption limit for individual is Rs. 22,000.

Partnership
Firm is one of the most popular assessable entities under the Income Tax Act, providing perhaps the best and the least questioned tax planning device. The Income Tax Act has adopted the same definition as given by the Indian Partnership Act, 1932, which defines 'Partnership' as a relation between persons who have agreed to share the profits of a business carried by all or any of them acting for all.

Under the Partnership Act, a 'Partnership' or 'firm' is nothing but a group of persons (as such is not a separate independent entity or person in law) and has no legal personality apart from the partners, whereas under the Income Tax Act, the firm is a separate and distinct legal entity chargeable to income-tax and, therefore, is a taxable unit. Therefore, the provisions of the Partnership Act in this regard cannot be applied to the Income Tax Act. A firm is not entitled for various incentives provided under the Income Tax Act for Savings, Expenses and Incomes and certain payments made to partners are disallowed in computation of firm's income.

Classification of firms
For the purpose of Income-tax, firms have been classified as registered and unregistered firms. 'Registered Firm' means a firm which has been registered under the provisions of Income Tax Act. This registration is separate from the registration under the Partnership Act. In this case of registered firm, after assessing the total income of the firm, the income tax payable of the firm itself is determined. Thereafter the share of each partner in the income of the firm less proportionate tax is included in his total income and assessed to tax accordingly.

Therefore, it can be said that income of a registered firm is subject to double taxation; (Income of a registered firm is taxable) first in the hands of the firm and thereafter the same income is taxable in the hands of partners. Whereas, on the other hand, an unregistered firm pays tax as its income like an individual and share in profits is included in the individual assessment of partners for the limited purpose of calculation of rate of tax. In other words, share of profits from an unregistered firm is not taxed again and included in the personal income of partners for rate purposes only.

Another classification of firms in firms carrying on profession and firms carrying on business. Section 64 (1) (i) is applicable to the firms carrying on business and not to those carrying on profession. However, both 'profession' and 'business' carry a wider meaning for tax purposes than generally understood. The tax rates for firms carrying on profession is a little lower than for other firms.

Tax Rates

As mentioned earlier an unregistered firm is liable to pay tax applicable to an individual, whereas a registered firm is taxable at concessional rates.

The maximum rate in the case of an unregistered firm for assessment year 1991-92 is 50% and minimum 20%. Whereas in the case of registered firm maximum rate is 15% for the professional firm and 18% after any other firm and minimum 5% for professional firm and 6% for any other firms. Basic exemption limit for registered firm is Rs. 15,000.

Company

A company has emerged as a form of business organisation and occupies a predominant place in the modern industrial era chiefly because of its superiority over other forms of business organisations such as partnership, individual ownership etc. Its growth has been accelerated by its prominent characteristics, namely, its identity as a legal person distinct from its members and the limited liability of its members. No wonder, therefore, the companies meet special treatment under the Income Tax Act as well.

Under the Income Tax Act, a 'Company' means any Indian Company or anybody Corporate incorporated by or under the laws of a country outside India or any institutions, associations or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of Central Board of Direct Taxes to be a Company. Therefore, any entity, not being a company within meaning of the Companies Act can be treated as a company for the purpose of Income-tax Act if so declared by the Central Board of Direct Taxes.

Tax Rates

For the purpose of levy of tax, Companies are broadly classified as :

a) Domestic and foreign company and

b) Company in which public are substantially interested and company in which public are not substantially interested.

In case of a domestic company in which the public are substantially interested tax is levied @ 40% whereas in the case of a domestic company in which public are not substantially interested tax is levied @ 50% if the company is trading and investment company and @ 45% in case of any other company.

In the case of a foreign company tax is levied at flat rate @ 65%. The tax rates mentioned above are in respect of assessment year 1991-92 i.e. on the income earned during the financial year ending on 31st March, 1991 and are also applicable for advance tax payable during this financial year (1990-91) whereas the tax rates were higher by 10% in all cases except in the case of foreign company for the assessment year 1990-91.

Special benefits

Certain provisions of the Income Tax Act confer benefit only to corporate assesses.

There are in respect of inter-corporate dividends and royalty etc. received by an Indian Company from certain foreign enterprises. As per provision amended by the Finance Act, 1990, dividends received by a domestic company from another domestic company are deductible from the total income upto the amount which the receiving company has distributed as dividends. Earlier the deduction was restricted upto 60% of the dividend received and balance was taxable as business income.

Similarly, if an Indian Company receives any royalty, commission, fees or any similar payment from the Government of a foreign State or foreign enterprise in consideration for the use outside Indian of any patent, model, design, formula, process etc. provided by the Indian company. Then 50% of such consideration brought to India is deductible from the total income of the receiving company.

Wealth tax & Gift tax

Finance Act, 1983 revived in a limited way, the levy of wealth tax on companies which was suspended by the Finance Act, 1960.

As per Section 40 of Finance Act, 1983 wealth tax is chargeable on the net wealth of every company except a company in which the public are substantially interested at the rate of two per cent of such net wealth.

Further this section provides that only certain specified assets like precious metal, precious or semi precious stones, ornaments and utensils of these precious metals and stones, land other than agricultural land, motor cars etc. will be included in the net assets of a company for the purposes of levy of wealth tax.

Therefore, it can be said that companies in which public are substantially interested are not liable to pay wealth tax at all whereas, wealth tax an other companies is chargeable only in respect of certain specified assets which are usually non-commercial assets.

Activity 7

Compare the tax provisions with respect to the different organisational forms. If you were planning to set up a small restaurant. Keeping the tax provision in mind what organisational form would you select for yourself? Give justification for your choice?

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Under the Gift Tax Act also companies in which public is substantially interested form a privileged class.

No gift is leviable on the gifts made a company in which public are substantially interested. Whereas, in the case of other companies gift tax is chargeable per cent 30% for the assessment year 1991-92.

Recent changes

The Gift Tax Bill, 1990 was introduced in the Lok Sabha on 31st May, 1990 with an object to shift the burden of tax from donors to donees.

The new bill intends to levy tax on the gifts received by all class of companies except an Indian company which receives gift from any other company in a scheme of amalgamation.

This, the Gift Tax Bill, 1990 intends to withdraw the benefit extended to all company in which public are substantially interested.

Zeroing in-Making the Selection

Having understood the various forms and their relative advantages and disadvantages, you are in a position to finally decide upon the form you want to have for your enterprise. What are the decisions variables that you would like to evaluate these various forms on?

Following are some of the variables that you might consider :

1. **Your personal characteristics :** An entrepreneur's psychological build up affects his capacity to get along with others. His venturesomeners, his attitude to risk and uncertainty and capabilities to shoulder responsibilities among other things. Depending upon whether you are type of person who would like to go it alone or venturesome enough to try out something on your own, you might like to choose the form or organisation that allows you the freedom of decision-making. On the other hand, if you like working with others and happen to have hig perceptions of risk than you might like to share the risk of enterprise with others. These characteristics may also affect your appreciation of characteristics like unlimited liability and temporary existence.

   Apart from the personal characteristics, your risk taking capacity in terms of personal assets and credit rating would also affect your perception of risk inherent in these forms of organisation, their capital formation potential and the liability scenario.

2. **Your plans for expansion :** While choosing a form of organisation you would have to bear in mind your future plans regarding expansion and growth. As a sole proprietorship offers limited expansion possibilities it may have to be deferred as a choice in favour of the two other forms of organisation.

3. **Needs for raising capital now and in future :** Closely related to the point of expansion is the point of your capital needs, both present and future. In case the enterprise require low capital outlays in present but heavy outlays in future, you would like to choose a form which facilitates the raising of capital to meet your future requirements—for example, a company on the other hand if both present and future capital outlay requirement is high you would go in a form of organisation which enables a larger amount of capital to be brought into the organisation. For example a Company or a partnership.

4. **Need for continuity of the enterprise :** Of the project envisaged by you is a relatively short-term project, you can choose any form of business organisation. On the other hand if it is a long-term project, you would not like any contingency to threaten the continuity of your business and should choose a form that enjoys stable existence.

5. **Tax adjustment :** No one form of legal organisation can claim the best tax advantage in all instances. You have already studied the differential tax rates applicable to these forms of organisations. It is, however important to underline one important difference between these forms while computing the taxable income of the organisation. In proprietorships and partnerships any withdrawals of cash by owners during a particular financial year, even in the form of salary, are considered to be withdrawals of capital for tax purposes. In closing the books at the end of the financial year such amounts cannot be recorded as operating expenses of the business. Proprietors and partners pay income-tax on the total profit shown irrespective of any withdrawals made during the year. In case of a company, since it is an artificial person, it is considered a separate unit owners of small enterprises who operate as companies can charge reasonable salaries to the business and these become operating the expenses of the company. They are accordingly deducted while calculating the net taxable income of the company. It is the remaining income which is taxed. The person drawing salary files a separate return and pays personal income tax on his incomes. You might like to consider these and related tax implications while choosing the form of your organisation.

9.9 SUMMARY

Most entrepreneurs when they plan to go into a business of their own, do not have a very clear idea if the relative merits and demerits of choosing one legal form of organisation over another. The sole proprietorship has the great advantage of your being your own boss and total autonomy, but it is also characterised by unlimited liability and possible limitations of size through limited owner resources. Partnership offers the advantage of pooling the human and non-human resources if more than one person, ease if formation and tax advantages, but has the limitation of temporary life, unlimited liability and non-transferability of interests. Similarly, while the company form of organisation offers you the benefits of perpetual succession, limited liability and transferability of interest, entrepreneurs may feel hampered by a far greater amount of legal formalities regarding formation and management and the incidence of possible higher taxation. You must weigh all these and other relative characteristics of these organisational forms carefully before you choose a form of ownership for yourself.

9.10 SELF-ASSESSMENT QUESTIONS

1. What are the different ownership forms available to you as alternatives? Discuss each form in brief.
2. Compare a sole proprietorship with a partnership in terms of
   a. Tax advantage
   b. Secrecy
   c. Capital raising ability.
3. What are the important characteristics of the partnership form? Is it necessary to register a partnership? Describe the effects of non registration.
4. What are the major advantages that the company form of organisation has over others? What are the important distinctions between a private and a public limited company?
5. Discuss the taxation provisions related to the different organisational forms.
6. After going througn this unit, can you develop a framework to help you to decide upon the selection of the organisational form? What criteria would you take into consideration in deciding upon the ownership form of your organisation?

9.11 FURTHER READINGS

Richard M. Hodgetts *'Effective Small Business Management'*. Academic Press Inc. 1982, Orlando, Florida.

MBA-3.2

Utter Pradesh
Rajarshi Tandon Open University

Management of New and Small Enterprises

Block

4

OPERATING THE SMALL SCALE ENTERPRISES

BLOCK 4 OPERATING THE SMALL SCALE ENTERPRISE

Once the desirable form of organisation has been chosen, the business plan finalised and implemented, the stage is set for starting the business operations. The issues in the operational management of the small enterprises differ significantly from large ones, apart from the scale of operation. This block deals with the issues relating to management in the various functional areas, in case of a small enterprise.

Unit 10 deals with the financial management issues in small enterprises. Financial planning in respect of asset and liability management and growth strategies has been explained. The issue of performance evaluation as an input in financial decision making has also been touched upon.

Unit 11 discusses the issues related to management of operations on the production floor.

Unit 12 on marketing management issues discusses the issues of market segmentation, marketing planning and market segmentation in the context of a small enterprise.

Organisational relation in small scale enterprises have been characterised by non-formalised personnel practices and direct control of the owner manager on most personnel related issues.

Unit 13 discusses the organisational relations practises and related issues in the small enterprises.

UNIT 10 FINANCIAL MANAGEMENT ISSUES IN SSE

Objectives

After going through this unit you should be able to:

- explain the important issues related to financial management in small enterprises,
- discuss conservatism and liquidity management in small enterprises,
- describe issues related to management of assets and liabilities,
- discuss the implication of financial planning for growth.

Structure

10.1 INTRODUCTION

In this unit we shall discuss a few key issues in financial management. Typically entrepreneurs of small scale enterprises start well, but somewhere down the line, in their day-to-day operations they miss the route to success. In more than half such cases the reasons identified can be attributed to financial mismanagement. At times, such entrepreneurs have a feeling of well being but year end consolidation of accounts indicates a disastrous situation, loss or almost being on the verge of losing. At other times, opportunities come by but cannot be grabbed. Reasons for such inadequacies can be inability to think of sources of funds or rigidity on the part of the banker. The banker's non-cooperation, most often, is due to entrepreneur's inability to maintain accounts and strongly present his case. All such problems can be suitably tackled if, all along, an entrepreneur keeps upper most in his day-to-day operations certain considerations in financial management.

Activity 1

State whether True/False.

1) Financial management is of secondary importance in most small scale enterprises. True/False
2) Opportunities come and can be grabbed provided one is well-equipped including financially. True/False
3) A vague feeling of well-being is not necessarily a sure indicator of enterprise success. True/False

10.2 BUSINESS SUCCESS OR FAILURE

The sine qua non of all business is profits. And, the basic underlying soundness of business governs its health and growth. Loss may be an indicator of business failure and, profits may indicate success in day-to-day business operations. This may not always be so. The surest test of business success would be sufficient and growing profits — profits that are growing from year to year.

An important factor, therefore, is to determine whether the nature of business has the potential to produce profits. There is no point selling a lakh rupees worth of your product if it costs a lakh and quarter to produce it. In the short run, lack of sufficient cash at the right time has compelled fundamentally sound businesses to fail. Therefore, one must determine not only need for profit but cash as well. The moral of this unit is : knowing where, when and how to obtain finance is of limited value if you have little idea how to use it effectively.

The basic soundness of a business can be measured through **Breakeven Analysis** and the cash needs can be estimated through **Cashflow Analysis.** These methods provide a balance between accuracy and simplicity. The two analyses should not be taken as mere mathematical or accounting exercises but should be employed as proper planning tools to determine and ensure sound business health.

Profit or loss of a business is usually measured with the help of the annual Profit and Loss Account. This statement, quite often, is prepared five to six months after the year ends. Therefore, the effect of today's decision shall be known seventeen or eighteen months hence. This is too long a period; in as much time much water would have flown down the Ganges and an irreparable damage may have been set in the unit. You should endeavour to prepare the Profit and Loss Account more frequently, say every month, to measure the success of your day-to-day operations and, if just in case there is a loss, take timely corrective action.

Activity 2.

Fill in the blanks:

1) Any business is run for ....
2) Profit is .... necessarily a sure indicator of success.
3) Adequate and .... profit is a sure indicator of business ....
4) The basic soundness and cash needs of a small business can be measured with the help of .... analysis and .... analysis.
5) Profit and Loss Account measures the business .... or ....

10.3 EVALUATING PERFORMANCE

A successful small business person must not only be 'very committed' and 'hard working' but also 'have a firm sense of direction'. Only then will he be able to guide the business unit to its set goal. To ensure that a business unit is running on its set course would require monitoring and evaluation. The performance of various business activities would be measured by relating output to input. This would require establishment of performance standards. Without a standard there is no logical basis for taking a decision for corrective action. An entrepreneur must have basis for comparison to enable him decide or act.

Such standard can be of two types : **judgement standards or engineering standards.** Based on experience standards are set by what has been and a judgement of what they could be. The latter is intuitional or judgemental. Managers and technologists like to improvise standards based on modern techniques, such as operations research, work study etc. To non-technical people "engineering standards" may appear theoretical. Though they may be so they embody the latest scientific techniques and theories. After all, yesterday's practice is today's theory and, today's theory is tomorrow's practice. So also is true of standards. They are revised based on new revelations. However, while setting standards it is desirable that the staff whose performance is required to be measured is consulted and taken into confidence.

Comparing performance with standards is the most critical process in management control. This is called "monitoring". This means "to detect" or "to tap" so as to ensure things are working out as they were originally planned. In actual performance there would be distortions. At times this may be owing to lack of appreciation of such performance standards. This can be arrested by asking for report, oral or written. This also avoids doubts between the giver and the receiver.

Performance standards can even be set based on budgeting. The three major functions of budgeting are **planning, motivation** and **control.** Accordingly, Planning Budget, Motivation Budget and Control Budget can be prepared. Planning Budget could be the Operating Budget, Financial Budget or the Projected Income Statement.

Motivation Budgets can be sales quotas or other motivational budgets. Control Budgets are prepared in order to assign responsibility for cost incurrence within the business enterprise so that they are controlled at the point of incurrence. Unlike planning and motivational budgets which are prepared only once, control budgets require preparation on two occasions. First, they are prepared in advance of the activity to indicate what the cost should be. Then at the end of the reporting period, these budgeted costs are adjusted to the actual volume of activity so that they can be compared with the actual cost incurred.

Business performance can even be measured based on ratios. In this case the standards used can be : historical, horizontal and budgeted. Historical standards are based on past performance of the business enterprise. Therefore, new enterprise will not have historical standards. New firms can employ budgeted standards which are arrived at after perparing the budget for a set period based on planned performance. While these two standards are internal, horizontal standards are external as they measure the performance of your business enterprise with other firms in similar industry or trade. Both internal and external anlyses are important. Internal analysis tells how you have performed compared to the past. But when the external environment turns unfavourable and your business performance declines, is it indicative of your good or bad management? External analysis will now come to your rescue. If your decline in performance is less than the industry average you have not performed so badly.

For performance evaluation to be useful and effective it must be done periodically and regularly. And, it should be followed by suitable corrective action to ensure your SSE runs along the course charted.

Activity 3

1) Explain the significance of performance evaluation for financial management.
2) What could be the different methods to evaluate performance of a small business enterprise?

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10.4 PRINCIPLE OF CONSERVATISM

Owing to their high achievement-orientation entrepreneurs are dynamic, optimistic and are usually noticed to be going in for high goal setting. This is reflected in their exercise in planning, budgeting and setting standards. Formulating a project report is an exercise in planning. In project reports the tendency is to indicate a higher value of sales, production and profits in a bid to impress bankers. Such a disposition is not recommended from a good financial management point of view. Sound financial management assumes conservatism.

Conservatism in accounts means that of the many pictures or positions available, the least attractive is presented. The principle is "anticipate no gains or revenue and provide for all possible losses or expenses". It is not to suggest that you go on providing for expenses or losses which would reasonably not occur or ignore revenues which should be reported. This principle is recommended in situations of uncertainty, in situations where a clear-cut decision is not possible usually in issues relating to valuation, classification or timing. It is a guide for unusual situations in which clarity is missing and not a hard and fast rule.

Following the principle of conservatism will save you from awkward situations, save your face and your reputation. Suppose in your project report instead of following the principle of conservatism you indicate the most hopeful sales, production and profits. Based on these, loans are got sanctioned. But tomorrow, when profit and other projections slip, the entrepreneur will have to cut a sorry figure with his financiers. So also for cash flow forecasts. If one is too optimistic, the slightest downturn in business activity can create situations of cash crunch and subsequent loss of reputation.

In the case of inventory of merchandise one can take the cost price or market price. The convention, based on principle of conservatism, is to take the lower of cost or market value. This is the principle for writing books of accounts or while submitting stock statements to your banker.

In case of fixed assets, particularly land and building, one has the option to reflect the cost price, market value or book value (cost price less depreciation). As per the principles of conservatism reflect the least figure. In case of some banks, the value of buildings owned is reflected in the balance sheet as just Re 1 while the actual value is several crores! This reflects their strength.

Undue optimism can be harmful. Following the principle of conservatism would add intrinsic strength to your financial position and condition. It is far better to be humble than to eat a humble pie.

Activity 4

1) Enumerate the pros and cons of being conservative and optimistic in small business.
2) While valuing stocks the value to be taken should be
   a) Cost price
   b) Market price
   c) Market price including premium especially when the commodity price is controlled.
   d) Lower of (a) and (b).
3) While reflecting the value of land and building as also other fixed assets one should indicate :
   a) the cost price
   b) market value
   c) book value
   d) None of the above

Ans : 2(d) 3(c)

....

....

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....

10.5 ASSET MANAGEMENT

The funds raised in a business are invested in various assets. Such investments have associated costs. These could be interest on loans, debentures etc. or opportunity cost in case these funds are owned. If proper care is not taken the costs would go up, profits shall come down and the return on investment would decline. Therefore, analysis and supervision is required at pre-investment stage — that is, before the assets are purchased — and at the post-investment stage — that is, after the assets have been purchased. To maximise return on investment every business firm should endeavour to ensure maximum utilisation of each and every asset. Here, we shall discuss management aspects of only those assets where pitfalls are commonly observed in the daily operations of a small business.

Land and Building

A new business firm would do well to start operations in a rented premises rather than owned premises. In big cities entrepreneurs usually prefer to go in for owned premises as their value appreciates fast. This is not advisable for a new enterprise as a substantial portion of the total project cost — usually 25 to 30% — gets locked up. Such funds are interest bearing; own land and building invites a variety of rates and taxes, may be even wealth tax. Then there is cost of repair, maintenance and depreciation of building. All told rent of as big a premise normally works out lower than total of all recurring costs likely to incurred on own buildings. To that extent one can earn more profits. When funds to be invested in land and building are your own, there is opportunity cost associated.

In any business there are opportunities that constantly keep coming your way. If funds are available they can be grabbed and extra profits earned. On the other hand, if funds are locked up in owning land and building one may not have funds to grab a large order or make use of extra discounts a supplier may offer on goods and services.

Finally, owning land and building increases total debt. This increases debt-servicing liability. With less profit, chances of default in debt servicing (paying interest, instalment etc.) are more. The appreciation in value of land and building is also meaningless for a going concern unless you are thinking of winding up the business !

You may think of going in for own land and building only after business is established for a few years and operations are established.

Trade Debts

Trade debts or bills receivables are extended by small enterprises either to gain a niche in the market or to increase sales usually in difficult times such as business recession. Sufficiency of the extent of trade debts is usually judged by receivables turnover ratio also called collection ratio or book debts to sales ratio. Too high a ratio would indicate early collection of book debts and too low would indication extension of long credit periods. The question of how long is long is usually resolved by making an inter-firm and intra-firm comparison. An absolute position is never a good indicator; a comparison gives a clearer picture.

If in the past 45 days credit was being extended and now this is reduced to 40 days it indicates a better position. But, if on a comparison with other business in same business and in the same area, one discovers the usual credit period extended in 30 days then 40 days credit is indicative of a bad position!

At times, the receivables turnover ratio may become low because there is a big chunk of old trade debts that are being carried. To enable a proper analysis a statement of trade debts age-wise would then be in order. Business with bad paymasters may be slowed or completely stopped especially when they are not paying.

The measurement of receivables has always been a contentious issue in small enterprises. Small Scale Entrepreneurs usually do not like to write off bad debts (uncollectible accounts) and reduce these from the balance sheet as well as the income statement lest this reduces profits. To impress bankers and other creditors they prefer to carry on trade debts even when they are over a year old. This is bad practice.

At times, entrepreneurs increase the trade debts unusually high especially around year end so as to show an increased sales in a bid to impress their bankers. Such a practice is not only undesirable but can be dangerous and costly.

Neither too high nor too low a receivables turnover ratio is good. A too high a ratio may indicate over-zealousness in collecting trade debts; possibly at the cost of hurting some good old-time customers resulting in loss of future business.

Too low a ratio may mean an undesirably large trade debt portfolio resulting in locking up of costly funds besides increased collection cost and bad debts. The right credit period will be determined by a trade off between cost of funds, cost of cash discount or early payment, bad debts, collection cost and profitability. Such business must leave a net surplus. Stretching credit term to obtain sales is not indicative of a wholesome condition.

However, as a general rule when business is good, period of trade debt should be reduced and when business is bad, credit on sales may be extended. This sounds simple but would not be so easy in actual practice.

Cash

Cash is a necessary evil. It is necessary as it acts as a lubricant that facilitates day-to-day business operations. But then, why is it an evil?

Is cash a source of funds or a use of funds? Have a look at the balance sheet shown in Figure 1.

Fig. 1 : Balance Sheet

LIABILITIES		ASSETS	
	Rs.		Rs.
Proprietor's Capital	....	Cash	....
....	....	....	....

Where is cash appearing? On the asset side. That means it is a use of funds. Whatever cash you are having whether in hand or at bank is coming from funds which are liabilities. Such funds have cost associated with them. Therefore, carrying too high a cash increases cost of funds and carrying too low would mean facing embarrassment in business owing to inability to make payment of expenses due. One must carry the right amount of cash which would be an amount just sufficient to enable you make payment of all expenses as and when they fall due.

Activity 5

1) A new enterprise should preferably own/rent out business premises.
2) In times of business boom trade debts should be ....
3) Cash on hand is
   a) source of funds
   b) use of funds

Ans : 1) rent out 2) decreased 3) use of funds

10.6 GROWTH STRATEGY — THE FINANCIAL IMPLICATION

Good financial management is one which ensures that a business enterprise is live and kicking. That is, it is growing. Business growth is dependent on solvency, credibility, ability to raise funds, availability of resources and liquidity.

Solvency

To keep the business running its solvency must be maintained at all times. Solvency is the ability of the business firm to pay off all debts. It is measured by Tangible Net Worth.

> **Tangible Net worth**
> **= Own funds (or Net worth) − Intangible Assets**

If tangible net worth is positive, the enterprise is solvent; if negative, it is insolvent. Such industrial units have negative tangible net worth.

Bankers also keep a track on solvency position by monitoring the debt; equity ratio. In Indian situation a debt-equity ratio of 3:1 is allowed for SSE. Usually the tendency amongst small entrepreneurs is to borrow to the hilt, that is, keep debt-equity ratio to its maximum level of 3:1. In a new enterprise, during gestation period losses are certain. If these losses exceed your equity, the firm's tangible net worth becomes negative : it becomes insolvent or sick. Thus a stigma gets attached to it and the firm spoils its chance of growth.

Debt-equity ratio should be kept as low as possible. If you start with 3:1 reduce it. How? (a) By reducing debt; and, (b) by increasing equity. Equity can be increased by investing additional funds from your own sources or by ploughing back profits. A reduced debt-equity ratio gives you leverage to borrow. It indicates your debt raising capacity. Thus, if debt is Rs. 2 lakhs and equity Rs. 1 lakh, debt-equity ratio is 2:1. Since 3:1 is permissible, when opportunity comes for growth, you would be in a position to borrow an additional Rs. 1 lakh.

Credibility

Credibility is the bedrock on which all businesses — small, medium or large — run. As the old adage goes, if reputation is lost everything is lost. Maintaining credibility in business not only ensures sustainability but also growth. Credibility ensures finance and availability of adequate finance leads to business viability. The reverse relationship is also true. If business proposal is viable, finance is available; and, if a businessman has finance his credibility gets more easily established. This relationship can be expressed in the following equation.

Viability = Finance = Credibility

How is credibility established? By sticking to your commitments. If you project certain sales, production and profit, work assiduously to achieve them, to make them come true. Similarly, if certain payments are committed to your bankers, creditors or others, ensure you pay them when due. If you keep paying your material suppliers on time, when need arises you telephone them to send double the normal quantity (say, Rs. 2 lakhs as against Rs. 1 lakh normally) the supplier gladly obliges. Thus, on telephone you have raised Rs. 2 lakhs. If, however, supplier was paid hesitantly and with great difficulty, would he so oblige? Definitely not. This is true of all creditors, including bankers. Thus credibility ensures finance and hence business growth.

Trading on Equity

A business enterprise using borrowed capital along with its own capital is said to be "trading on equity". If equity is more than borrowed capital it is described as highly geared; and, if the own capital employed is less than borrowed capital, it is said to be low geared. In a highly geared capital the return on equity is generally low and in low geared capital it is high provided cost of capital is, lower than return on capital.

Suppose return on capital is 30%. Interest on borrowing is 15%. The return on equity is shown in Table 10.1 in situation 1 of high gear and situation 2 of low gear.

Table 10.1

Effect of trading on equity

Situation	Gearing	Equity	Borrowing	Profit Before Interest	Profit After Interest	ROE
1.	Low	Rs. 1,00,000	Rs. 2,00,000	Rs. 90,000	60,000	60%
2	High	2,00,000	1,00,000	90,000	75,000	37.5%

Thus, low gearing gives
ROE of 60% and high gearing 37.5%

This makes trading on equity attractive. An owner of SSE would like to borrow more and more to maximise ROE. When there is business boom, there are orders on hand, economy is looking up, there is enthusiasm everywhere and even creditors like to lend more and more leading to a situation of **overtrading**. However, in business such situation does not last forever. Soon recession may set in or a large order may get cancelled or any unfavourable event may take place. With drop in sales, profits would decline, interest payment may suffer and creditors will stop further credit suppliers and may even take away their materials. Thus, stocks decline, current assets are reduced, production suffers, profits are further affected, worker morale goes down payment position further worsens leading to a definite slide-down and general gloom all over. A healthy business is now sliding down to its doom.

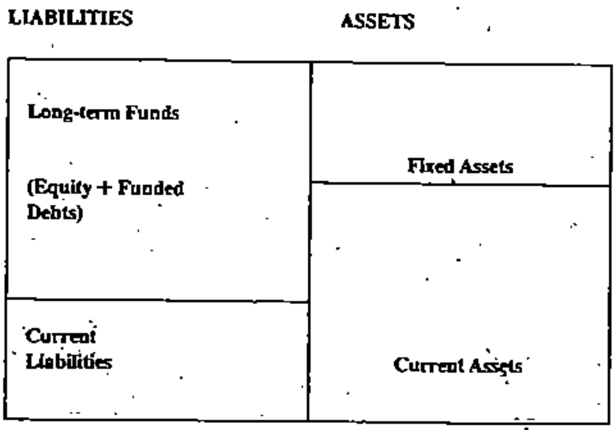
The moral is : keep trading on equity within healthy limit. Even if attractive opportunities are before you, do not borrow more till you have widened your equity base **pari-passu**. That is, hold on to your debt-equity ratio; do not allow it to worsen.

Liquidity

Liquidity is short-term solvency. While insolvency is faced only once in the life of a business illiquidity is faced from time to time. Liquidity of a firm is its ability to meet expenses incurred in the short run. This is most essential for maintaining the firm's credibility and potential for growth.

It is measured by Current Ratio, Acid Test Ratio and Net Working Capital. Current Ratio should be 2 or more (minimum acceptable to an Indian banker is 1.33). Alongwith the Net Working Capital should increase from year to year. From Figure 2 it may be observed that for Current Ratio to be more than one, current assets will be greater than current liabilities meaning thereby investment of funds from equity and other long-term sources in current assets. Current asset-size remaining same profit level would remain constant lowering return on equity. This is not tenable to the owner of a business. He would, therefore, be interested in lower Current Ratio at the expense of impairing liquidity.

Fig. 2 : Concept of NWC



To tide over liquidity crunch, the entrepreneur should prepare projected cash flow statements on a monthly basis and initiate corrective action well in time.

Activity 6

1) If own funds are Rs. 1,70,000 and intangible assets Rs. 90,000, tangible net worth is Rs. ....

2) If current assets are Rs. 2,50,000 and current liabilities Rs. 1,30,000, net working capital is Rs. ....

3) Increase in net working capital from Rs. 50,000 last year to Rs. 75,000 this year indicates the liquidity of the firm has ....

Ans. 1) 80,000 2) 1,20,000 3) improved.

10.7 MANAGING LIABILITIES

If finances of the business enterprise are to be managed comprehensively, both assets and liabilities require to be managed. Managing liabilities is as important as asset management. Many a firm is known not to have progressed well because it could not manage its trade credits or accrued expenses.

Accrued Expenses

In business many expenses like rent, salaries and wages, taxes etc. get accrued but are not payable. Till such time as the expenses are incurred but not payable (the enterprise has taken the benefit of such goods or services on which account expenses are incurred) they are termed as accrued expenses. These are an important source of funds. When an enterprise requires funds, the entrepreneur should not pay off the expenses till they become payable. There is no sense in being over-zealous and making early payments especially when the enterprise requires funds. There are mutually and legally acceptable due dates. Hold payments till such dates and utilise such funds for day-to-day operations. But do take care that on due dates sufficient funds are available to make payments and maintain business credibility.

Trade Credits

Like accrued expenses trade credits should not be paid off till they are due, especially when your firm is in need of money. By making timely payments credibility is assured.

If credit is extended on sales, it makes sense to avail credit on purchases. By and large these should be equal though this is not a hard and fast rule. If trade debts are more than trade credits, it means market of your product is not so good. If trade credits are more than trade debts it could mean you are overstretching credit purchases or chasing your customers for early payments or demand of your product is so high that customers pay on cash or near cash basis.

However, remember nothing in this world is free. Your supplier may not charge interest on credit supplies but it is in built. He may overcharge; or, sell inferior quality goods; or, give least preference in supplies and so on. At times, suppliers offer cash discount on early payments. Suppose you buy Rs. 1 lakh worth of goods on 30 days credit and the supplier offers 2% cash discount for payment within 10 days. Then for availing Rs. 1 lakh credit for 20 days you lose 2% discount. This works out to 36% ($2\% \times \frac{360 \text{ days}}{20 \text{ days}}$) on an yearly basis. In fact, you gain 18% per annum if the cash discount is availed of even by taking bank credit at 18% interest!

The use of credit from suppliers is an important source of meeting short-term requirements of funds. But this should not be at the cost of losing suppliers' goodwill or compromising on other trade terms.

Activity 7

Fill in the blanks.

1) Accrued expenses are a .... of funds.
2) To maintain credibility of the business firm trade credits should be paid off in ....
3) Suppliers offer .... discount for early payments.

Ans. 1) source 2) time 3) cash

10.8 MAINTAINING ACCOUNTS

Accounts are the raw material of financial planning. Financial accounting provides financial information to parties within and outside the business — the entrepreneur, banker, creditors, statutory Government agencies and others. Survival and success of a small business depends on a healthy relationship between its three key players — the banker, the small business person and the accountant. Most small business firms do not maintain accounts even when they have availed bank credit which always stipulates provision of adequate book-keeping. To the small-scale entrepreneur an accountant is a costly provision. The business operations, according to him, are not many and he feels he knows and understands all the transactions.

In the absence of proper accounts, losses are incurred, pilferages take place; dues remain uncollected and most operations are conducted in the most unbusiness like manner. Bankers and statutory requirements like stock statements, returns, financial statements are either not prepared or prepared late and in an adhoc manner creating mutual suspicion and affecting relationship.

If an entrepreneur cannot afford a full-time accountant, he should employ a part-time accountant or maintain accounts himself. The cost of hiring an accountant gets paid many times over. All successful businessmen have an accountant handy and maintain up-to-date accounts. They realise in the absence of adequate book-keeping and account they do not have a correct picture of costs, expenses, sales, trade debts, trade credits, tax liabilities, profits and return. It helps in establishing credibility with bankers, tax authorities and others. Every businessman must regularly maintain proper accounts to ensure financial planning, mid-way corrective action and profits.

10.9 SUMMARY

Critical issues in financial management require to be constantly borne in mind to ensure that a small-scale business enterprise remains healthy. Planning for profits must be ensured at all times by resorting to periodical performance evaluation. While reporting such performance, actual or planned the merits of being conservative should not be lost sight of.

Proper utilisation of various assets is critical to profit maximisation. Along with credibility, solvency and liquidity are essential for enterprise growth. During emergencies liability management can be helpful. But all this would be possible only if proper books of accounts are maintained. An accountant ensures criticalities involved in financial planning and management are taken care of through timely provision of financial information. All aspects of financial management contribute in small or big measure to maintaining business survivability and growth.

10.10 FURTHER READINGS

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UNIT 11 OPERATIONAL MANAGEMENT ISSUES IN SMALL SCALE ENTERPRISE

Objectives

After going through this unit you should be able to:

- discuss production operations management aspects of small scale enterprises,
- identify features of production operations regards small enterprises,
- comment upon facilities development in SSE,
- discuss importance of enterprise maintenance and quality control.

Structure

11.1 INTRODUCTION

In this unit you will learn in general the aspects of production and operations management (POM). Production Management has traditionally been associated with manufacturing. Today it encompasses a large variety of other activities concerned with the conversion of inputs into outputs using physical resources so as to provide the desired utility/utilities to the customer while meeting the organisational needs of effectiveness viability and quality. POM activities extend to hospitals, educational institutions, offices, Petrol Pumps, transportation (rail, road or air) maintenance workshops, banks etc. You cannot think of an activity which cannot be brought within the purview of POM. Graphically the concept has been represented as shown in Figure 1.

Figure 1 : Production and Operation Management — Some Cases

Sl. No.	Case	Input	Physical Resources Used	Output	Type of Input/ Output	Type of Utility Provided to the Customers
1.	Inorganic Chemicals Production	Ores	Chemical Plant and equipment, other chemicals use of labour	Inorganic chemical	Physical input and physical output	Form
2.	Outpatient ward of a general hospital	Unhealthy patients	Doctors, nurses other staff, equipment, other facilities	Healthier patients	Physical input and physical output	State
3.	Educational Institution	'Raw' minds	Teachers, books teaching aids	'Enlightened' minds	Physical input and physical output	State

Sl. No.	Case	Input	Physical Resources Used	Output	Type of Input/ Output	Type of Utility Provided to the Customers
4.	Sales Office	Data from market	Personnel, office equipment and facilities, etc.	Processed 'information'	Non-physical input and non-physical output	State
5.	Petrol Pump	Petrol (in possession of petrol pump owner)	Operators, errand boys, equipment, etc.	Petrol (in possession of the car owner)	Physical input and physical output	Possession
6.	Taxi Service	Customer (at Railway station)	Driver, taxi itself, petrol	Customer (at his residence)	Physical input and physical output	Place
7.	Astrologer/ palmist	Customer (mind full of questions)	Astrologer, Panchanga, other books, etc.	Customer (mind hope-full)	Physical input and physical output	State
8.	Maintenance workshop	Equipment gone 'bad'	Mechanics, engineers, repairs equipment etc.	'Good' Equipment	Physical input and physical output	State and form
9.	Income Tax Office	'Information'	Officers and other staff, office facility	Raid	Non-physical input and physical output	State (Possession)

Productivity

The only way our standard of living can be improved is to increase our per capita productivity. You can meet your requirements (or export the surplus to earn very valuable foreign exchange) only if you produce more. This increasing the per capita productivity as essentially the main mission of POM. Productivity is the efficiency of converting the inputs (such as labour, materials, equipment (machines), finances, time and space, technology and management skills) into tangible outputs (such as goods, services, enhanced sales or exports, greater customer satisfaction and higher operating efficiency). Mathematically

$$\text{Productivity (P)} = \frac{\text{Output (O)}}{\text{Input (I)}}$$

Thus productivity is not only achieving higher levels of output but also at the least cost of input which in other words is maximisation of resources or alternatively reduction of wastefulness. Productivity should not be confused with production. To increase production, you must produce more by merely using more labour, better machinery, more finances and more time.

11.2 PRODUCT/PRODUCTS SELECTION, DEVELOPMENT AND DESIGN

a) Products Selection is one of the key strategies decisions of any organisation which commits itself to the product/products selected for a long time to come. The organisation attempts to match the changes in environment, technology and consumer requirements while finalising the design.

b) Production Selection can be through any of the following processes:

i) **Market research for existing products:** You will have to very carefully evaluate the economic viability keeping in view the market segment you wish to capture, the region you wish to dominate and the customer level you wish to serve.

ii) **Research laboratories:** You will come across a large number of national organisations like National Research & Development Corporation who are continuously developing new products and are prepared to sell the patents. In ongoing organisations research projects, properly initiated can come up with good product variations, improved versions and even newer products to serve better the same consumer needs. Such products have by far the least risk and good pay off.

iii) **Innovation and Technological Upgradation:** You can achieve this by brain storming, use of consultants and selection of newer technologies, may be even at the drawing board stage, through a world wide research. While such products promise the highest pay off, they also carry the maximum risk.

Product development is a very detailed, deliberate and drawnout phase. The product should be deliberated upon in maximum possible detail. Various environmental factors internal as well as external, particularly the market reaction (test marketing, publicity, demonstrations, etc.) should be thoroughly evaluated. More the time you spend on product development, better become your chances of success. You can build the pitch to such an extent that the product launching should be pulled by the market demand.

Product Design : You will have to keep the following considerations in view:

i) Test effectiveness.
ii) Quality commensurate with cost and market sustainability.
iii) Maintainability and Reliability.
iv) Servicing
v) Ease of Production.

Design alternatives invariably are plenty. Decision matrix is the evaluation of various trade offs. A hypothetical chart is shown below at Figure 2. It is wrong to go for cost reduction to remain competitive. Today's customer wants cost effective quality products.

Figure 2 Design Characteristics Trade Off

It is difficult to visualise any project design which is not affected by its features whether essential, desirable or optional. Value analysis also has a major role to play. Final selection of the product characteristics is the relative importance, you attach to various features and contributory elements given below :

Function	Maintainability	Safety & Security
Reliability	Cost	Environmental Hazard
Accessibility	Appearance	Productionability

Activity 1

With respect to your own organisation or any other small organisation that you are familiar with, discuss the considerations affecting the choice of product design.

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11.3 DEVELOPMENT OF PROTOTYPE, SELECTION OF PROCESS AND PLANT AND MACHINERY

a) Prototypes are generally the hand made models which concretise the product formulation ideas. National Small Industries Corporation has regional Prototype Development Training & Testing Centres to cater to these needs of small entrepreneurs.

b) These prototypes are thoroughly evaluated keeping in view the considerations covered above under the sub-heading "Product Design". A very detailed costing is done. Choice of raw materials is made. Material estimates are drawn. Various manufacturing processes are contemplated. Requirement of work force of different skills is estimated. Work norms to evolve labour costs are thought of. You would thus see that the development of prototypes, is a very vital stage before going ahead with the manufacture and launching of a new product or any improved version of the existing product. You can have the maximum pay off if you put product through value analysis. Value Analysis or Value Engineering is a coordinated approach to isolate costs which neither increase life, nor add to use value, esteem value or quality. In other words it is achieving desired function at the lowest cost without sacrificing quality.

c) You have now reached the next stage of selection of plant and machinery and finalisation of process. The two are interrelated. If you go in for a conventional manufacturing process, you can manage with standard machinery available in the open market. But should you select a high tech process, you have necessarily to look for NC/CNC/ONC machines may even be based on robotics. These processes are no doubt costly but suit high volume operations particularly involving special purpose machines.

d) The last stage in the product development is the manufacture of Pilot Production Models. These are checked and re-evaluated for various functional aspects such as tooling, material estimating, rate of production, cost of production, quality control techniques reliability and maintainability. You are now ready to launch free flow production.

11.4 PLANT LOCATION

a) Plant location is a strategic decision and has to be arrived at after careful deliberations of various factors involved. It is a one time decision and cannot be retracted without paying heavy penalties. You may have to make this decision based upon the following considerations:

   i) Proximity to Market.
   ii) Nearness to raw materials.
   iii) Adequate power and water arrangements and other infrastructural facilities.
   iv) Transportation facilities and their costs.
   v) Labour and wages.
   vi) Laws and taxation.
   vii) Incentives, Land costs, subsidies Backward areas.
   viii) Climate.
   ix) Ecology and environmental factors.
   x) Political conditions.

Market: While considering the market you have not only to assess the existing segment and the region but also the potential growth, newer regions and the location of competitors. If your products are fragile and susceptible to spoilage proximity to market gets added weightage. Similarly if the transportation costs add substantially to your product costs, then also a location close to the market becomes all the more essential. If the market is widely dispersed, it is possible to statistically find out the point which will provide the lowest cost of distribution. In case of goods for export, processing facilities gains importance.

Raw Materials and Supplies being near to raw materials allows you to get better supplier service and to save on incoming freight. Other supplies include tools, equipment. ancillaries, vendor supplies etc. Here you look for promptness and regularity of deliveries. If the raw materials are bulky low in cost or perishable and to be consumed as such locate the plant near to raw materials source. Suitable examples can be steel and cement industries. In the small scale sector these could be food and fruit processing. Meat and fish canning, jams juices and ketchups etc.

Power Water and Other Infrastructural Facilities : Depending upon the types of industry these could assume disproportionate priorities. Power situation should be studied with reference to its reliability, adequacy, rates (Concessional if any) own requirements, subsidy for standby arrangements etc.

If power contributes substantially to your inputs costs and it is difficult to break even partly using your own standby source, you may essentially have to locate your enterprise in lower surplus areas such as Maharashtra or Rajasthan. Similarly adequate water supply at low cost may become a dominant decisional factor in case of leather, chemical, rayon, food processing and such like industries. Just to give you an idea what gigantic proportions can water as a resource assume, please note that a tonne of synthetic rubber requires 60 thousand gallons, a tonne of aluminium takes 3 lakhs gallons, a tonne of rayon 2 lakh gallons and a tonne of steel 30 thousand gallons of water.

Other infrastructural facilities include. telephone, telegraph, fax, telex, post office, roads, etc.

Transportation : Movements of materials involve huge costs. Packaging in case of delicate products adds considerably to the transportation charges. The most common media are rail, road, air and water. Liquids and gases can be effectively handled through pipe lines. HBJ pipe line is a very progressive step in this direction.

The cost of moving material per kilometer tapers off as the length of the hawl increases.

A break even analysis can be made to decide about the selection of the most economical media. Linear programming is commonly adopted for tackling transportation problems. Even a mix of two or three media may prove more cost effective. Some of the examples where transportation media becomes the deciding criteria for plant location are:

i) Jute industry on river Hoogly.
ii) Sea food industry next to port of embarcation.

Labour and Wages : Availability of sufficient labour skilled in the required trades and category is yet another factor for enterprise location. Presence of technical training institutes in the area prove useful. You can study labour relations though turnover rates, adsertism and liveliness of trade unionism. Such information should be available from existing industries of the area. Whether the labour is rural based or urban; is also a point to consider.

Wage levels prevalant in the area also have an important bearing on location decision. Higher regional norms are supposed to be compensated by increased output levels of traditionally industrial labour. While you may get cheaper labour in industrial backward areas, cost of their training and fall in efficiency may not allow you to take this course.

Laws and Taxation : Laws prohibit putting up polluting industries in prone areas. In order to control industrial growth laws are enforced to decongest some areas while simultaneously encourage certain other areas.

Taxation is a centre as well as State Subject. In some highly competitive consumer products, its quantum may turn out to be the negative factor while its relief may become the final deciding factor.

Incentive : For balanced economic growth of the country, very lucrative backward area concessions such as subsidies, tax holidays for number of years, assured and cheaper power supply price concessions for state purchases etc. have been made available. Land also is available at a very much cheaper rate. A large number of entrepreneur have benefited from these incentives. Other factors being comparative this factor becomes the decision maker.

Climate : affects human efficiency and behaviour a great deal. Wild climate is conducive to higher productivity. Certain industries take jute and textiles require high humidity.

Ecology and Environmental Factors : Manufacturing plants apart from producing solid waste can also pollute water and air. Stringent waste disposal laws, in case of certain industries, add to the manufacturing cost to exhorbitant limits.

We as the society members at large have no alternative but to pay this price for maintainance of our ecological balance in the longrun.

Political Conditions : Political stability is essential for industrial growth. Community attitudes such as the "Sons of the Soil Theory" may not be viable in every case. You have also to look into the availability of community services such as housing, schools & colleges, recreational facilities and municipal services.

There are many qualitative and quantitative techniques adopted to interpolate the above factors to arrive at a logical decision. The simplest and most commonly adopted is weight rating method illustrated in Figure 3 below.

Fig. 3
Plant Location : Decision Matrix

SL. NO.	FACTORS	FACTOR WEIGHT RATING	POTENTIAL SITES (WEIGHTAGES) S1 WEIGHT RATING	S1 TOTAL WEIGHT-AGE	S2 WEIGHT RATING	S2 TOTAL WEIGHT-AGE	S3 WEIGHT RATING	S3 TOTAL WEIGHT-AGE	S4 WEIGHT RATING	S4 TOTAL WEIGHT-AGE
1.	Proximity to Main Market	11	12	(132)	16	(176)	13	(143)	17	(187
2.	Nearness to Raw Materials	11	19	(209)	12	(132)	17	(187)	13	(143)
3.	Infrastructural Facilities	5	8	(40)	4	(20)	7	(35)	5	(25)
4.	Transportation Costs	5	10	(50)	14	(70)	9	(45)	11	(55)
5.	Land Requirements & Costs	15	8	(120)	12	(180)	9	(135)	13	(195)
6.	Incentives	20	13	(260)	19	(380)	16	(320)	20	(400)
7.	Availability of Trained Labour	15	16	(240)	10	(150)	15	(225)	7	(105)
8.	Laws & Taxation	10	6	(60)	9	(90)	7	(70)	10	(100)
9.	Ecology & Environmental Factors	2	4	(8)	2	(4)	3	(6)	2	(4)
10.	Climate	6	4	(24)	2	(12)	4	(24)	2	(12)
				1143		1214		1190		1226

Activity 2
Talk to three entrepreneurs, one in manufacturing, one in trade and one in services business. Discuss with them to find out :

a) the factors considered by them in the location decision.
b) how have availability of transportation and labour affected their location decision.

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11.5 PLANT LAYOUT

Plant layout is an analytical and economic arrangement of various facilities like workmen machines, equipment, materials, plant services, incoming, in service and outgoing materials, tool and intermediate storage and inspection areas with a view to achieving their optimum utilisation. The facilities layout also is a strategic decision since a layout once implemented cannot be changed easily. Some of the advantages of a good layout are:

i) Higher Productivity.
ii) Economic utilisation of floor space and other operating areas such as loading & unloading.
iii) Better supervision and control.
iv) Better working environment and employee safety.
v) Minimum material handling.
vi) Lower investment in plant and building with better maintenance facility.

Flow Patterns : Basically there are three types of flow patterns viz. horizontal, vertical and the combination of the two. These patterns can be evolved by the use of flow process chart.

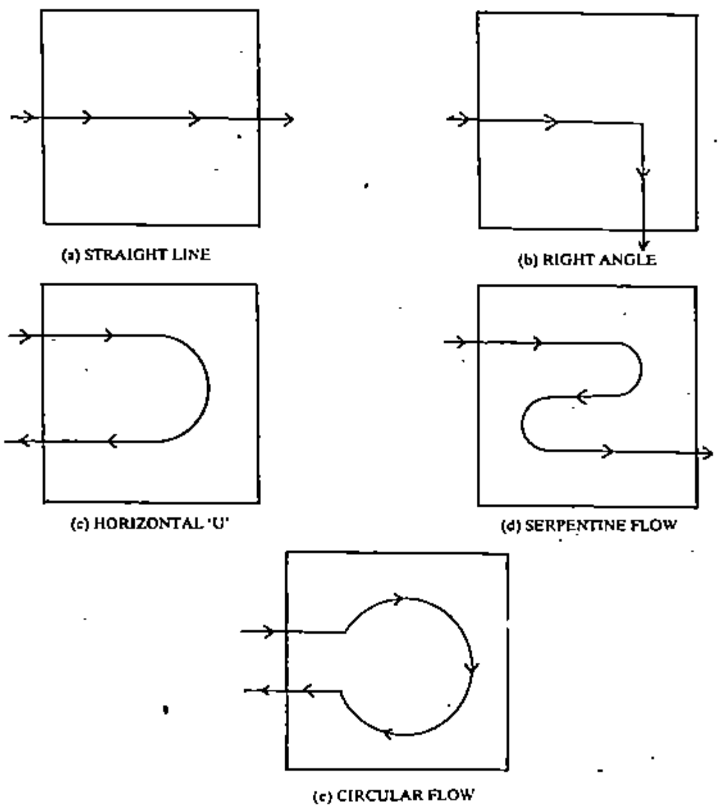
Activity charts and or flow diagrams. The best way of analysing a flow pattern is by the use of a Travel Chart. The basic types of horizontal flow lines are:

i) Straight line
ii) Right Angle
iii) Horizontal "U"
iv) S flow and
v) Circular flow.

There are diagrammatically represented in Figure 4 below. The choice of a particular flow pattern would depend upon the types of the building, the types of the products, type of the raw materials used and their frequency of use; out inspection, packing and despatching requirements. Mostly the "U" flow and circular flow patterns are commonly used.

Figure 4

FLOW PATTERNS



Activity 3

Visit a restaurant which you can classify as being in the small sector. Comment upon how has the layout of facilities added to or detracted from the ease of movement. Could you suggest some alternative layout?

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11.6 INDUSTRIAL ENGINEERING

No production and operation management study is complete without the knowledge of industrial engineering commonly called Work Study. The ILO hand book states work study as a term used to embrace the techniques of method study and work measurement which are employed to ensure the best possible use of human and material resources in carrying out a specific activity. A more descriptive definition as given by British Standards Institute is: "Work Study is a generic term for those techniques particularly method study and work measurement which are used in the examination of human work in all its contents, and which lead to a systematic investigations of all the factors which affect the efficiency and economy of the situation being reviewed in order to effect improvements."

Method study is the systematic and scientific evaluation of existing or proposed plans & performance of any work system and the evaluation of improvements through the analytical process of critical examination. Method study if concerned with reduction of the work content of the operation. While making suggestions for improvements, economy in human efforts, reduction of unnecessary fatigue and the development of a better physical working environment should be taken note of. Method study in its genealised field of activity can also be termed as work simplification. Conventional symbols used in work analysis are as under :

Standard Symbol	Name of Activity	Definition of activity
○	Operation	An operation occurs when information is given or taken, planning or calculation takes place operations could be 'do' make ready 'or' put away type.
→	Transportation	It occurs when an object is moved from one operation to another or from one place to another.
□	Inspection	To check and or verify qualitatively and or quantitatively.
D	Delay	A temporary halt or interference which comes up in the planned sequence of operations.
∇	Storage	It occurs when an object is intentionally kept aside.
□	Combined	Various combination of simultaneously occurrence of two activities.

Work Measurement : It is the application of techniques designed to establish the time for a qualified worker to carry out a specified job at a defined level of performance. It is concerned with the investigation and reduction of the ineffective time and the subsequent establishment of time standards for the operations based on the work content evaluated by method study. There are a number of work measurement techniques. Some of these are mentioned below :

i) **Time Study :** This is a direct observational techniques in which an industrial engineer watches a worker's time and rates the work. It is a very simple and straight forward method but viewed with suspicion by the workers who think that all stop watch work is either to set a rate or to cut it.

ii) **Activity Sampling :** It is a random observation method under which state or condition of the object or person under study is noted for yes/no position from the proportions of observations in each category, inferences are drawn concerning the total work activity. Accuracy of the result will increase as the number of observations increase. Activity sampling is less presented by the workers while the results can be fairly accurate compared to time study. Work Sampling is based on the statistical law of probability and is derived from the statistical sampling facility provided by the mean and standard deviation of a sinomial distribution that closely approximates to a normal carve under certain set of conditions.

iii) **Predetermined Motion Time System (PMTS) :** Workers acceptance of time standard is very essential for any work norms to be effective. It has been engaging the attention of management theorists so as to avoid all irritants of the process. One such evolution has been the PMTS. Here each element of work such as reach, turn, grasp, move apply pressure etc. etc. have been broken down into very very small basic movements.

They could be of the order of 1/30th of a second and are determined by studying cine film records. Tables for times for these basic movements under varying conditions are published. These are universally acceptable. The industrial engineer now allocates precise timings for elements of work involved in his process under study by combination of various basic movements as given in the tables and totalling their timings. PMTS requires training since the definition of basic elements is not always obvious.

iv) **Synthesis and analytical estimating :** Within any organisation the same type of elements of work will recur even if the total job differs. Work measurement can be achieved if the times of all these elements are added together. If originally these timings were obtained by time study, then the process is called 'Synthesis' whereas if obtained by the use of knowledge and experience, then the process is called analytical estimating.

Industrial Engineering has gained enormous importance the world over. It tells you the ways to improve productivity. Labour input costs cannot be worked out unless work norms have first been established. To work out correct work norms you have to report to industrial engineering. There are also essential for wage settlements with workers as also to draw up incentive schemes.

11.7 PRODUCTION PLANNING AND CONTROL

Production Planning consists mainly of the evaluation and determination of production inputs such as labour machinary and equipment, materials and utilities to achieve the desired goals. The definition of the goals is also a part of the Production Planning process. The process of Production Planning can be divided into the following three phases:

i) Allocation
ii) Routing
iii) Scheduling

Allocation : The marshalling of all the resources of production which will be required to perform the task is called allocation. This division is concerned with the provision of space, the supply of labour availability of machines and equipment and the provision of materials and spaces. Allocating of resources is done taking all the other commitments into consideration and the priorities allotted to various products.

Routing : includes planning of where and by whom work will be done, determination of both the path work will follow and the necessary sequence of operations.

Routing as applied to manufacturing is the application of predetermined orderly logical and economical sequence of operations through which materials, parts and sub assemblies must pass to prepare them during each successive operation for their subsequent development into larger sub assemblies or completed products. The Route card or commonly called Job Card is prepared by the Methods Dept. Products are prepared from materials processed within the plant, purchased from vendors, precured on sub contract from other manufactures or the combination of the three. You must coordinate their routing so as to avoid held ups at the assembly line. It is sometimes necessary to allow controlled banks at work stations. This helps maintaining the flow in following manners:

i) Allows time minor machine changes or sequencing
ii) Does not let the rejections due to stage inspection to interrupt the free flow.
iii) Rejections in the meantime can be reworked and put back on the line.
iv) Helps tide over absenteeism for a short while.

Scheduling : Covers many portions of the manufacturing cycle. Master schedules are prepared for various periods of time. The ideal master schedule is the one that forecasts accurately specific items and the quantities to be produced daily for the maximum number of days. The ideal schedule though is seldom realised in actual practice because it is not always possible to ensure all variable inputs to be available at the right time and right quantity.

Production Plan is drawn in advance, may be three to six months. It starts with the corporate planning for the year. Annual aggregate plan dovetailing the requirements of the Annual Marketing Plan is drawn up, indicating monthly schedules. Production Plan is issued in advance so that the requisite materials procurement and placement is done in time to avoid any bottlenecks in operations. A good production plan has two parts viz. Firm Schedule for the ensuing month and tentative schedule for the succeeding month or two months. The advantage of such a type of scheduling is the preplanning that can be done by concerned agencies such as Materials, Purchase, Finance etc. This way bottle necks can further be avoided.

In jobbing type of work or a Service Centre or over-hauling workshops where large number of products serials are simultaneously progressed, computers are used for production planning and control. In certain cases spares/materials inventory alone runs into thousands, even lakhs of items. They have to be available just in time to avoid heavy inventory carrying and storage costs.

Production Control is the updating and revising procedure where according to the requirements of the implementation, the labour assignments, the machine allocations, the job priorities, the rates of lines flows, the schedule routes etc. may be critically examined and changed. It is basically a monitoring and correcting mechanism which goes on throughout the production process of the already drawn production plan and schedule. For frequent revisions of schedules you need a supervisor to look after the changes, monitor them and communicate decisions fast on the production lines. For efficient contract, production schedules are drawn to as detailed a level in time as possible thereby exercising tight control over the smallest of deviations. In order to continually monitor the schedule, many control techniques are adopted, some of these are:

i) Periodic Production Review Conferences
ii) Reports and Returns and their review
iii) Charts & Graphs
iv) Growth Charts
v) Line of Balance
vi) CPM/PERT
vii) Computers

Integrative Nature of Production Plans: PP&C is an effort to optimise the process of conversion of raw materials into finished goods. PP&C therefore has to be an integrated function to derive maximum benefit out of planning. The procurement and inspection of raw materials the inventory levels of in process and finished goods, Quality Control, plant maintenance, production costs, manpower and training and the machinery equipment all have their influence on the planning of production operations.

Activity 4

a) From your nearest industrial area, choose a sample of 10 small enterprises. Discuss with them to find out what mothods of production planning and control are being used by them.

b) In case you think the methods used are not adequate what methods would you like to suggest?

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11.8 WORKS SERVICES AND THEIR MANAGEMENT

In the modern complex production operations environment, for every hand engaged directly in production, there are a number of hands supporting his effort. Without this it would be impossible for the production man to carry out his functions smoothly and uninteruptedly. A fine anomaly can be drawn from our defence services. For every ground soldier in the front line, flier in the air or a seaman in the high seas, there are 3 to 5 men supporting him from behind. To achieve efficiency in production, work services such as materials, procurements and personnels training, plant maintenance, Quality Control, R&D, PP&C, healthy, safety, fire fighting supervision, etc. have to be equally if not more efficient. In costing work services are accounted as overheads. Due to technological advancements works, services costs, have gone many times higher than purely production costs. But these high costs are offset against increased productivity. Work services practically include every functional aspect of an enterprise except the workforce directly deployed on production lines and may be the personnel functions. Some of these functions are mentioned in brief in the succeeding paragraphs.

Material Management: Materials account for 70 to 80 per cent per unit cost of production. Thus it deserves and occupies a high place in POM. You should be already aware of various inventory management techniques such as ABC & VED Analyses. ABC deals with the calculation of annual costs of each item in the inventory and listing them in descending order of value. You will notice that 5 to 10 per cent of the top number of items account for about 70 per cent of the total consumption value. They need the most attention. Call them 'A' items. Next 15 to 20 per cent of the items account for about 20 per cent of the total consumption value. They are called 'B' items. Persue them periodically. Remainder 70 to 80 per cent of the items account for about 10 per cent of the total consumption value. Call them 'C' items. Delegate their responsibility to the lowest functional level. You would have seen that ABC Analysis is based purely on grading the items according to the usage alone. Some items even though less costly in monetory value, may be vital for running the plant. These could be machinery spares, test equipment and other stores required for plant maintenance. Hence ABC Analysis should be done in conjunction with VED Analysis. VED stands for vital, Essential & Desirable. Vital items should be taken case of at the highest materials management level while essential items can be dealt with at middle level and desirable items can be delegated to the lower levels. Newer techniques are being practiced in the sphere of materials management. There is a concept of Zero Inventory where materials are procured in the quantity immediately needed and are passed on to production line straight away. While all these new concepts are efforts towards costs cuttings and have their pay offs they are not able to eliminate conventional well beaten techniques.

Plant Maintenance : i) Sophistications in technology have led to very high cost general as well as special purpose machines such as NC/CNC/DNC machines. Similarly tools, gauges and test equipment have become highly costly. It is not only the high initial costs but also the penalties you will have to pay in case of their breakdowns (even very temporary) that have made the plant maintenance as such as an exceptional area of POM, meriting specific attentions at the corporate level. In the technological sphere, specialisation like plant Engineering has come up. Failures are a natural phenomenon. You at best can achieve longer MTBF (Mean Time Between Failures) there are basically four types of maintenance systems viz.

i) **Breakdown Maintenance :** This is a crises situation and has to be dealt with on war footing. Its possibility cannot be completely eliminated. In the organisational set up, maintenance special Repair Personnel are earmarked and they swing into action moment the breakdown occurs leaving all other routine work aside.

ii) **Scheduled Maintenance :** Normal wear and tear of any equipment can be determined statistically to a fairly accurate state. Keeping this in view the equipment manufacturer issues periodic inspection and servicing schedules along with the equipment which should be meticulously followed just as is done in case of aircraft, locomotives and other critical ground equipments.

ii) **Planned Maintenance :** It is slightly different than the scheduled maintenance in that the maintenance plan is issued by the plant Engineer well in advance and the equipment being put through the planned maintenance is made available for the duration. Normally planned maintenance so executed that it causes the least amount of disruption in the production activity. It is thus carried out either during off shift hours or on weekly off days.

iv) **Preventive Maintenance :** It consists of routine actions taken in a planned manner to prevent breakdowns and ensure operational efficiency economically it starts with daily cleaning, oiling and inspection by the operator himself and goes on to periodic lubrication turning up and testing by the maintenance department. Faults noticed by the operator or his superior during the usage are reported and immediate repairs get done before the fault causes a breakdown.

v) **Other aspects of plant maintenance :** include all other areas of equipment management, operation of services and facilities such as :
   i) Maintenance of buildings and other equipment on the shop floor.
   ii) Maintenance of transport external as well as internal like conveyors, forklift trucks, cranes etc.
   iii) Provision of standby power, water and other facilities like air conditioning, compressed air, water coolers etc.
   iv) Housekeeping including seweraging, gardening footpaths.
   v) Health, fire fighting and industrial safety.

Miscellaneous Works Services

i) **Materials Handling :** In any manufacturing orgainsation, the product has to pass through many processes before assuring its final stage. It has been computed that on an average 50 tons of various materials are moved to achieve one ton of finished goods. Material handling costs money and yet does not add any value to the product. Some of the factors to be considered while tackling the material handling aspect are:
   a) Should be as nearly automatic as possible to keep the cost low.
   b) Use gravity as an aid.
   c) Movements should be in straight line & as straight as possible like frictionless rollers.
   d) Moves to be in straight lines.
   e) For fixed paths use conveyors.
   f) Integrate production control, inventory control and material handling.

Some of the Material Handling Equipment are

   a) Chutes, inclined rails, gravity roolers, conveyors.
   b) Conveyors such as powered rollers, belt or chain conveyors, apron conveyors and overhead conveyors.
   c) Elevators overhead runaway, trolleys & lifting stocks.
   d) Cranes-fixed, overhead as well as mobile.
   e) Trucks and other wheeled vehicles.

ii) **Fire Fighting :** Fire prevention measures have become a statutory obligation. Requisite fire fighting equipment such as extinguishers, beaters, water and sand buckets should be provided. Today highly sophisticated electronic fire alarm systems having audio as well as video signalling are available. Fire fighting contingency plans should be drawn up and left updated. It should cover on duty as well as off shift situations. Proper unit areas for workers and entrance for fire-men and equipment should be earmarked. Men should be properly trained in the handling of the equipments. More practices should be periodically carried out. It is always better to take out an insurance policy against loss due to fire. Still more important is to review it periodically with the help of insurance advisors or consultants.

iii) **Accident Prevention :** A safety officer should be appointed by name. Proper position should be put up at prominent places with work areas. Gloves and goggles etc. should be provided for hazardous jobs. Exhaust fans in the areas where fumes got generated should be required. Gangways should be kept clear. No oily surface, regular scraping of shop floors, guards on machines and conveyors are some more measures to achieve accident prevention.

iv) **Health, Hygiene and First Aid :** Environment should be kept as clean as possible. Adequate latrines and urinals with running water, water coolers, electric fans, exhaust fans etc. are some of the essential requirements for a healthy and conducive work environment. A first aid post with trained staff must be established on the shop floor. Certain percentage of men should be trained in first aid specially resuscitation due to electric shock and such take serious accidents.

v) **Energy Management :** This is gaining tremendous importance not only as a cost saving measure but a national emergency. Maintain your power lines to correct specifications specially the switches. Mechanical power transmission should be properly adjusted, well lubricated and with least friction. Switch off power tools even when not in use for short intervals. Electric motors should be of very good quality and correct rating.

11.9 QUALITY CONTROL

Quality is the performance of the product as per the commitment made by the producer to the consumer. A product is called a quality product only when it satisfies certain criteria for its functioning. Bureau of Indian Standards is doing a yeoman service by designing and laying down various criteria for a very large number of industrial and domestic product. A product should not only satisfy the criteria at the time of manufacturing but the same performance should be available over a reasonable length of time.

Quality assurance is a strategic decision. Thus it is the responsibility of all functional managers viz. Purchase, Production, Operations, Warehousing (Storage) and the transportation and packaging. Quality implementation is total organisational effort.

Control Charts

i) Variations in any process can be described in terms of central tendency and dispersion. Central tendency is for the samples to stay as close to the criteria as possible while dispersion is described as the extent to which the variation from the criteria exists you have also to understand a bit more of statistics before we can apply it for evolving our quality control measures. Central limit thereon states that the means of the samples tend to follow a simple statistical distribution called normal distribution.

ii) Therefore the procedure you follow will be:
   a) Take a few samples at a time. Measure their quality characteristics.
   b) Find the mean of the sample. Also measure its range of dispersion.
   c) Gather statistics for the ranges and the means of the various samples taken over frequent or regular intervals of time.
   d) Plot these statistics approximately on a graph paper.
   e) You have your control chart ready now to guide you as to when a particular process needs to be rectified and in what manner.

iii) Based on the sample size, there is a definite relation between the standard deviation of the population and the standard deviation of the sample mean. In other words inspection of samples means statistical inspection of the whole manufactured lot.

$\frac{\text{Population}}{n}$ and

U population

where

standard deviation

means

value of the measured characteristic

mean of the values of x observed of the sample

sample size.

x chart

i) This is the control chart for the control tendency. It is also called the average control chart. You fire the lower and the upper control limits for the values of x. Usually these limits are ± 3 which give an accuracy of 99.97 per cent of the results. Fig. below indicates it graphically :

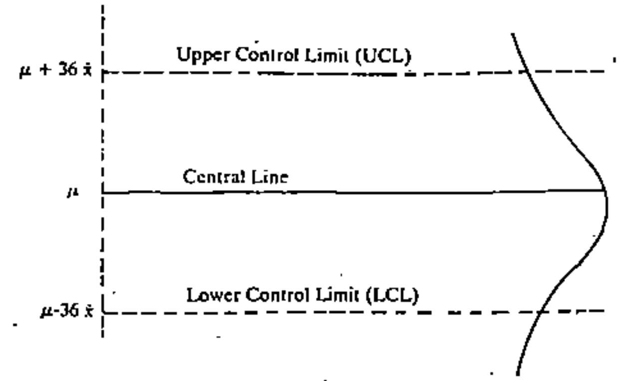

Fig. 5 : X Chart for Control Process

An illustrative example is given below :

A company using an automotive machine fills one leg sugar boxes with a lower limit of 1.000 and upper limit of 1.005 the machines has natural process variability of 0.0003. The three sinma limits of the machine therefore are 3×0.003=0.0009 leg on either side which means a total dispersion of 0.0018.

Since the specified dispersion is 0.005, the automatic machine is adjusted to fill 1.0025 Kg. boxes. This becomes the Central line. You are now ready to set up an x chart to detect when the machine goes out of the control. Weigh samples of n = 5 boxes and record × the average weight per box for each sample.

population

Using the formula X

n

We got

0.0003

5

= 0.000134 Kgs. and

3 × 0.000134

= 0.0004

Critical Examination

The chart represents four samples, a total of 20 one kg.	1.0034
1 kg. boxes. It will be seen that the fourth samples is on the	1.0029
upper control limit of the sample dispersion. All four	1.0025
samples show the tendency for positive values progressively	1.0021
indicating thereby that more sugar is being put into the	1.0016

boxes than what was intended and that the machines need fewer adjustment.

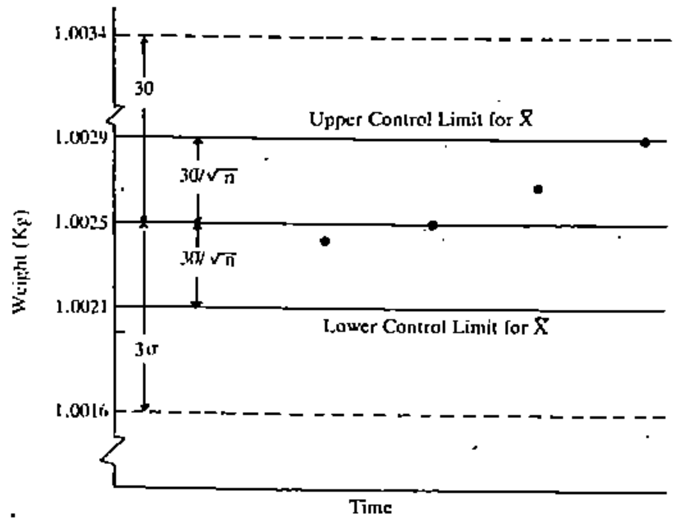

Fig. 6 : X Chart

R chart

Range control chart are for studying the dispersion. Range is the difference between the maximum value and the minimum value of the observations in a sample. We use the samples range for controlling the dispersion of the population. The formula are:

$R = d_2 \times$ pop.
and $R = d_3 \times$ pop

values of d_2 and d_3 for a given sample size n are read off from standard statistical and quality control tables.

The control limits for R charts are determined differently. There is no need for lower control limit which is zero for n<b

Now you apply the formula $R = d_2 \times 6$ pop

We have already seen that 6 pop is 0.0003 and the value of d_2 from the tables for n=5 is 4.918.

Hence $R = 0.0003 \times 4.918$
$= 0.00148$

Critical Examination

It will be seen that all four samples are close on the Centre line. Hence no statistically significant shifts are present. Hence the automatic weighing machine needs no adjustment as far as the range of the dispension is concerned.

0.0015	upper control unit R=0.00148
0.0010	Centre line R=0.00074
0.0005	Lower control limit R=0.0000
0.0000	

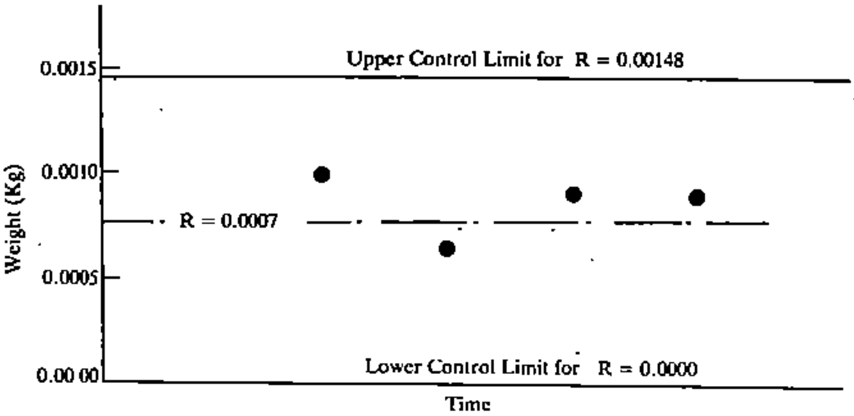

Fig. 7

Acceptance Sampling Plan

i) The sampling procedure consists of taking a small sample comprising in number i of items from a consignment of N number of items and accepting the consignment only if the number of defective items in the sample is less than or equal to a cost number C or else rejecting the consignment.

ii) An OC curve (operating characteristic curve) is typical of a particular sampling plan. Different sampling plans give size to different OC Curves.

In using the Acceptance Sampling Plan, there is a further probability that the lot may be accepted even of the quality is not really good. Also conversely the lot may be rejected if the quality is actually good. The first type of risk is called the consumer's risk and the second type is called the producer's risk.

Average Outgoing Quality Level

i) You know that on the basis of a sampling plan a lot is either accepted or rejected, if rejected it undergoes 100 per cent inspection at the suppliers or the consumer's and before its acceptance. The chance of bad quality entering the consumer's plant due to rejection of a lot is zero. The lead danger to the incoming quality is from the accepted ones. At any value of per cent defectives in the lot, there is a corresponding probability of acceptance of the lot. The defectives entering the plant due to the acceptance of the lot are = Probability of Acceptance (Pa) × Per cent Defectives in the lot (p). This is the Average Outgoing Quality Level. For each possible value of a p there is a corresponding ADQ value. You as the company are interested in knowing the maximum value of ADQ. This is the maximum risk your company is exposed to under the given sampling plan.

ii) The example below will illustrate the ADQL concept better.

The probabilities of acceptance of the lots of uniform size under an acceptance sampling plan are :

Actual Per cent Defectives in the submitted lots	Probability of Acceptance
1.2	0.731
1.4.	0.650
1.6	0.570
1.8	0.494
2.0	0.423
2.5	0.278
3.0	0.174
3.5	0.106
4.0	0.062
5.0	0.020
6.0	0.006

What maximum bad quality can enter the plant, under this sampling plan.

Solution

It is required to calculate the ADQL under the sampling plan because ADQL is the maximum limit of the bad quality entering into the Plant.

Actual Per cent Defectives in the submitted lots (P)	Probability of Acceptance (pa)	Average Outgoing Quality (ADQ×pa×P)
1.2	0.731	0.8772
1.4	0.650	0.9100
1.6	0.570	0.9120
1.8	0.494	0.8892
2.0	0.423	0.8460
2.5	0.278	0.6950
3.0	0.174	0.5220
3.5	0.106	0.3710
4.0	0.062	0.2480
5.0	0.020	0.1000
6.0	0.006	0.0360

Therefore the Average Outgoing Quality Limit (AOQL) is 0.9120. This is the maximum risk to which the plant is exposed under the given sampling plan.

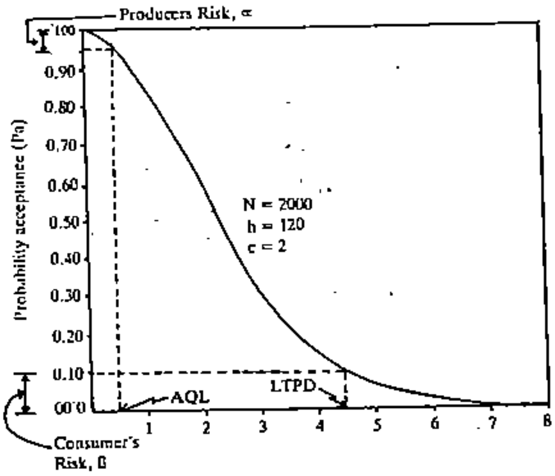

Fig. 8 Percent defectives in the lot (PD)

Double Sampling

The double sampling procedure consists of taking first a sample of size n, and inspecting it for defectives. If the number of defectives is less than or equals cut off number C_1, reject the lot. If the number of defectives are more than C_2, reject the lot. If the number of defectives are in between C_1 and C_2 then take another sample of a different size u_2. If the number of defectives in the combined sample of u_1+u_2 is less than or equal to C_2 then accept the lot. Otherwise reject it.

TQM (Total Quality Management)

The scope of quality management is not just devising a sampling plan for the acceptance/rejection of the incoming materials and controlling manufacturing process conditions. It is infact a job at every step of the company's activities.

Cost of Quality Control

i) There is no hard and fast rule as to what percentage of product costs should contribute towards the costs to be incurred for ensured quality standards. There are so many inponderables that it is difficult to precisely define this cost.

ii) However it should remain a minor percentage of the product cost is not disputed. That is why you do not go in for cent per cent inspection of each and every component. Furthermore, this percentage should remain as low as possible. It would depend on:
   a) Type of Product : its functional use, the hazard involved in the use penalties for failure etc.
   b) Quality awareness prevailing in the organisation by implementation of concepts of TQM, ID and QC.
   c) Costs for ensuring higher quality standards. You can go on improving in the quality if costs are no consideration and also if functional requirements so dictate. There is no optimum value between quality and product costs.

Activity 5

a) From the sample that you collected for activity 4 also collect information of quality control methods used.

b) Are these methods appropriate?

c) What modifications would you like to suggest?

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11.10 SUMMARY

The concepts of productivity, product selection, location, location decision, value engineering and quality awareness are as important determinants of success for a small enterprise as they are for a large scale one. This unit, on operational management issues, discusses in detail some of the underlying operational management concepts in relation to SSE and explain the significance of utilisation of these concepts for a small entrepreneur.

11.11 SELF-ASSESSMENT QUESTIONS

1) What are the important considerations in a product design selection? Explain with the help of an example.

2) Discuss the process of prototype development.
3) How do availability of transportation facilities and labour affect the location decision? What in your opinion are the three most important variables affecting the location decision?
4) What do you understand by method study and work measurement? How relevant do you think these are for a small scale enterprise?
5) What are the tools of production planning and control that a small entrepreneur can use? Comment with the help of an example.
6) Explain the various quality control tools that can be used by small entrepreneur.

UNIT 12 MARKETING MANAGEMENT ISSUES IN SSE

Objectives

After reading this unit, you should be able to:

- identify the target market segments for a product,
- familiarise yourself with the concept of marketing mix,
- appreciate the need for proper integration of various elements of marketing mix,
- take appropriate decisions with respect to product, price, promotion, and place (4 Ps) and
- ultimately formulate a sound marketing strategy for a small scale enterprise.

Structure

12.1 INTRODUCTION

In Unit 6 we understood the meaning and importance of marketing orientation, and the need for market assessment. Marketing orientation helps us to offer those products or services to the market that would satisfy some needs and wants of the customers. The exercise of market assessment helps us in understanding the nature and extent to demand, the competitive situation, and the prevailing trade practices.

When a product or service is offered to the market, several decisions need to be taken in regard to its marketing. For example, the price of the product has to be determined, its advertising budget has to be worked out, and the channels of distribution have to be identified. But before these decisions could be taken, we need to identify our target customers. Market segmentation helps us in this task.

12.2 MARKET SEGMENTATION

The market consists of a large number of individual customers having different characteristics. They may be living in different cities or towns. Their responses and preferences with respect to products, prices, promotional strategies, and distribution channels used, may not be homogeneous. Thus, different strategies and approaches are required to tap the potential in different types of customers. Inspite of this heterogeneity in the market place, groups of potential buyers, called market segments, can be identified which share certain characteristics of significance to marketing. The exercise of market segmentation helps us in identifying these groups. To put it in the form of a simple definition:

Market segmentation is the act of dividing the market into distinctive and homogeneous groups of customers.

Each group, thus formed, is called a market segment. The market segments that are of particular interest to a firm are called target market segments or just target markets. Let us try to understand this through an example. A firm manufacturing shoes wants to define its target markets. Suppose it specialises in shoes meant for men only. Women are, therefore, excluded from the target market. Since the shoes manufactured by the firm are rather expensive, it identifies those men who belong to high income group, and living in urban areas as its prospective customers. Thus, the target market of the firm can be defined with the help of three characteristics of its customers: 1) men, 2) belonging to high income group, and 3) living in urban areas

The identification of target markets helps an entrepreneur in fine tuning his efforts to the requirements of his customers. This fine tuning helps in reducing wastages and in achieving greater effectiveness. There are many examples where small enterprises tried to market their products without proper segmentation of the market, and suffered. One of the most common mistakes is to try to sell a product nationally (and sometimes internationally) when none of the resources — time, money, infrastructure, and manpower — allow this. Through market segmentation an entrepreneur comes to know who his customers are, where are they located, what price are they ready to pay, what product attributes do they value, how much do they buy, and how to communicate with them. He is not likely to commit mistakes such as pricing the product too high or too low, choosing wrong media or message for advertising, and selecting wrong kinds of middlemen.

When a firm concentrates its marketing efforts in one or two market segments, it has good chances of success and establishing itself firmly in the market. The target markets must be chosen on the basis of an analysis of the available marketing opportunities, and the constraints of the firm. They should be able to offer good sales and profitability potential, and have easy accessibility.

A market can be segmented on the basis of many defining variables. Some commonly used variables are :

1) Geographic variables
2) Demographic variables
3) Psychographic variables

Geographic variables

An important characteristic that distinguishes different groups of customers is their geographic location. A small firm may distinguish between the customers located in its own city of operation and those in other cities. Another firm may target its marketing efforts in an entire state, or in a couple of states. A large firm may identify a whole country as its target market. And a multinational corporation may like to spread its wings across different continents. With the larger target markets, territories or regions may be identified which require greater attention. Some areas, like rural or urban, may be viewed as more fertile (in terms of marketing opportunities) than the others. In all these cases, the geographical variables define the market segments.

Demographic variables

The term demography means the study of population. Various characteristics of population such as age, sex, education, occupation, income, family size, religion, nationality, and social class are termed as demographic variables. These variables are very commonly used as bases for distinguishing customer groups. They are easy to identify and can be well correlated with the characteristics of many products. For example, the particular age group of, say, six to twelve years can be easily identified, and correlated to products like toys, school bags, toffees, and comic books.

Psychographic variables

We have seen that the market can be segmented on the basis of geographic variables and demographic variables. However, to be really effective in marketing, especially of consumer products such as cold drinks and clothing, we need to know and understand our customers in greater depth.

We must study as with respect to certain other variables like their interests, attitudes, tastes, needs, values, opinions, and personality styles. These variables, since relating to the psychology of the people, are called psychographic variables. They are particularly important for fashion goods, and certain other consumer goods which come in varied designs and styles. An excellent example of psychographic segmentation in the Indian context is provided by the sellers of jeans (trousers). They seem to have identified their market as consisting of men and women who seek up-to-date goods, are pleasure oriented, casual in their life style, non traditional, and outward looking. The product design, advertising, and pricing, are all influenced by the identification of these personality traits in their potential customers. Some goods are projected as made exclusively for 'status seekers' with a high price tag attached to them. This type of psychographic segmentation is common for goods like brief cases, pens, furniture; sanitary fittings, cosmetics, and watches.

Sushil Cooler Co.

Sushil Tandon, the son of a high ranking government official, was in the final year of his engineering course. In his spare time, he tinkered with mechanical devices in which he showed a great deal of ingenuity.

He noticed that the traditional room coolers made a lot of noise, looked rather crude, and were not very scientific in design. As a part of his project in the final year of the engineering course, he assembled a cooler that was technically much superior to the commercially available coolers.

After passing out from the college, he set up a small-scale unit for the manufacture of room coolers in a metropolitan city of north India. He could get a rented shed for Rs. 1500/- per month. He took a loan of Rs. 1 lakh from a bank and his father promised him help to the extent of Rs. 50,000/- as and when required.

The first batch of coolers that came out from his factory, named Sushil Cooler Co., made him really happy. The coolers were distinctive; they bore the looks of an air-conditioner. They were comparatively silent in operation, and the cooling was effective.

While the normal coolers that were presently available in the market were priced at around Rs. 2,000/-, Sushil's variable costs were around Rs. 2,200/-, due primarily to better quality fan, pump, and accessories.

Being a technical man himself, Sushil is at a loss as to how he should market his product.

Activity 1

Try to identify the target market segments for Sushil Cooler Co. Take into consideration as many bases for segmentation as you think are useful for the product. List your recommendations in the space provided below.

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12.3 MARKETING MIX

There are several marketing aspects which are under the control of the entrepreneur. He can choose the features or attributes of his product, keep its price high or low, advertise it through newspapers or radio, sell it through own salesmen or retailers, and so on. In each decision, there are a large number of alternatives. He is always in search of a proper 'mix' of all the decisions so that they yield the desired results. There are four basic decision areas viz. **product, price, promotion,** and **place**, commonly called 4 Ps, which constitute the **marketing mix** of a company.

Marketing mix is an essential part of marketing management. It is a powerful concept which integrates various kinds of marketing decisions to form a well-knit marketing strategy. Every marketer uses this concept as a 'tool kit' to do his job of reaching the target markets.

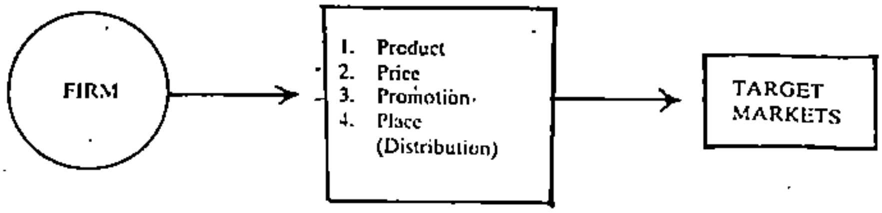

Fig. 1 Marketing mix

The overall **marketing strategy** of a company can be described by presenting its target markets and the elements of its marketing mix. As an illustration, let us briefly describe the marketing strategy of a hypothetical company ABC, manufacturing television sets.

Marketing strategy of ABC

Target market segments:	Households in high income group; living in urban areas; status conscious.
Product:	Black and white, and colour television sets incorporating latest imported technology.
Price:	High, to project superior quality image of the product; not high enough to make it out of the reach of those in the lower bracket of high income group.
Promotion:	Heavy advertising in high image magazines and on television, stressing mainly on product quality.
Place (Distribution):	Through high quality retailers in selected urban areas.

Marketing mix of different companies selling different products is bound to be different. However, there may be, and usually are, difference in the marketing mix of companies selling same product categories. This can be appreciated from the fact that another company manufacturing television sets may choose to have a substantially different marketing mix from that of company ABC mentioned above. These differences are not anomolies. They represent the strategies in the effort to get an advantage in the market.

Various elements of marketing mix have a lot of interaction within themselves. For example, a decision to enhance the product quality will have repercussion on its price; widening of distribution network will entail a corresponding increase in advertising; introduction of a promotional scheme to win over the competition will require active support from the channel members; and so on. This interaction between various elements of marketing mix requires that no decision should be taken in isolation, and its impact on the other elements should be carefully assessed. A good marketing mix will have a logical and consistent fit between all its elements.

Activity 2

In Activity 1 you have already identified the target market segments for Sushil Cooler Co. Now try to provide an outline of its marketing strategy (as we have done for ABC on page 8).

Marketing strategy of Sushil Cooler Co.

Target market segments: ....

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Product: ....

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Price: ....

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Promotion: ....

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Place (Distribution): ....

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You may have found it difficult to take decisions with respect to product, price, promotion, and place. Let us now discuss these marketing mix elements in some detail.

12.4 · PRODUCT

Anything that is offered to the market for sale at a price is termed as a product. It may be a physical product, like soap or toothpaste, or a service, like repair of typewriters.

Products can be broadly classified into three types:
1) Consumer products
2) Industrial products
3) Services

Consumer products are those goods which are bought by the individuals or households without requiring any further processing. Soap, toothpaste, refrigerator, furniture, clothing, and toys are examples of consumer goods. These consumer goods can be further divided into **durable and non-durable** goods. Durable goods are those which survive many uses and have a relatively long life (e.g. refrigerator, radio, television set, fan). Non-durable goods are those which are consumed in one or few uses and last a relatively short period (e.g. soft drinks, soap, shampoo, cigarettes). Consumer goods can also be classified in terms of the shopping habits of the consumers. We have **convenience goods** which are frequently purchased with minimum of effort in comparing or deciding (e.g. soap, toothpaste, newspaper, detergent). Then there are **shopping goods** which are bought after comparisons based on suitability, quality, price, and other features (e.g. sarees, furniture, readymade garments, electrical appliances). We also have **speciality goods** which have unique features and characteristics and, therefore, require special efforts on the part of the purchaser (e.g. Hi Fi stereo system, racing cars, sporting equipment, photography equipment).

Industrial products are those goods which are used primarily to produce other goods, or rendering some services to the manufacturers. These can be further classified into **capital goods** (e.g. machinery), **materials and parts** (e.g. raw materials and manufactured parts), and **supplies and services** (e.g. lubricants, repair and maintenance services).

As distinct from the normal physical products, we have services which are largely intangible in nature. Insurance, banking, transportation, entertainment, education, health care, excursions, and repairs, are all examples of services. Some services like teaching have a high degree of intangibility while some others like health care have both tangible and intangible components.

Product Mix

A product mix is set of all the products offered by a firm for sale. It may consist of a single **product line** such as different varieties of soap, or more than one product line such as different varieties of soap and toothpaste.

Small firms usually produce just a single product or a couple of products in a product line. However, as they grow, they have to take decisions with respect to their product mix. Following factors need to be considered while taking product mix decisions:
1) Profits and sales growth potential
2) Stability in sales
3) Capacity utilisation
4) Customer service and satisfaction
5) Utilisation of available know-how (both technical and managerial)
6) Cost reduction

A firm must periodically review its product mix so that only those products which are worthwhile to produce are continued with.

Product Attributes

A product has many features called its attributes. A soap has size, weight, essence, colour, hardness etc. as its attributes. A voltage stabilizer will have its technical specifications, external design features, and reliability. From the point of view of the customers, some attributes will be more important than the others. The importance of an attribute will also be determined by the wants of the particular market segments. While the high income market segment may rank the essence of a bathing soap as a highly relevant attribute, the low income segment may rank its size as the most important one. Thus, the relative importance of various product attributes should be judged in reference to the market segments of interest to the firm.

Since a firm has to operate in a competitive environment, the product attributes offered by the competition should also be studied. The exercise will enable us to determine the gaps that may be available in the market between what is offered and what is wanted by the customers. Once this information is available, we can position our product at a place which seems most appropriate from the market point of view.

Packaging

Packaging has traditionally been used to protect the goods, and to improve their handling convenience. Today it has acquired additional significance in terms of its promotional value. Many products like cosmetics, readymade garments, playing cards, agarbattis, and gift items including sweets and dry fruits have fancy and elaborate packagings which act as attraction to the customers. Some products like bread have to be packed, out of necessity, in a particular manner so as to protect them and increase their shelf life. Thus packaging performs many functions such as:

1) Protection from damage during handling, transportation, storage, and use.
2) Packaging makes it easier for the customers to differentiate between different brands, and to choose the one that is preferred.
3) It provides the consumers information about several product attributes including price, weight, name of the manufacturer, date of manufacture, contents, and expiry date (e.g. in case of medicines).
4) Good packaging helps in creating a favourable image of the product in the minds of the customers.
5) Packaging makes it easier for the members of the trade, and the consumers to handle a product. It can be systematically stacked in a store, and the consumers can use it without any inconvenience and wastage.

Several new materials and technologies are available today which have revolutionised packaging. We see soft drinks in more convenient and disposal tetrapacks, pain relievers in aerosol cans, and many items of household use in reusable plastic jars. Attractive and inexpensive plastic lamination is done on cardboard cartons. In general, while designing the packaging for a product, following points must be considered:

1) The functions which are expected to be performed through packaging;
2) The practices being followed by the competition;
3) The tastes and preferences of the target markets; and
4) The costs involved under different options.

Branding

Most products that are sold today are branded. A **brand** is a word, mark, symbol, or combination thereof used to identify goods or services. A **brand name** is that part of a brand that can be vocalised. Thus, Promise, Charminar, Lux, and Godrej are brand names. A **brand mark** is that part of a brand which can be recognised but not vocalised. Brand marks like telephone, monkey, and elephant can easily be identified for some popular products in the Indian context. A **trade mark** is that part of the brand which has legal protection for exclusive use.

Some of the advantages of branding are :

1) It helps in giving a distinctive image to the product;
2) It helps in communicating to the customers some desirable features of the product (e.g. Vicco Turmeric, Quickfix);
3) It makes it easier for the members of the trade and the consumers to order and identify goods;
4) It can help in providing legal protection to a product from limitation;
5) It helps in building up a loyal set of customers; and
6) It helps in earning goodwill which is useful for growth and diversification.

There are certain costs also associated with the decision to brand a product. A branded product requires good amount of promotion and as such adequate funds need to be earmarked for this purpose. Consistency in the quality of the product has to be ensured.

Activity 3

What product attributes would a customer in the chosen market segment (see Activity 1) look for in a room cooler? How would you like to position the product of Sushil Cooler Co. in terms of its product attributes? Suggest a brand name for the product.

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12.5. PRICING

By price is meant the amount of money that consumers must pay for a product or service. Pricing is one of the key elements of marketing mix. Pricing decisions greatly influence the profitability of a firm. Also, price seems to be the most handy tool available to a marketer for adapting his marketing strategy to changes in the competitive situation, and in the environmental factors.

Pricing decisions are quite complex and many factors — economic and non-economic — impinge upon them. These include:

a) Costs associated with the product;
b) Demand for the product;
c) Price-elasticity of demand;
d) Competitive situation;
e) Government regulations;
f) Behaviour of the consumers; and
g) Long-term and short-term objectives of the firm.

Some common pricing methods and strategies are discussed below:

Cost-plus method

This is perhaps the most commonly used method of pricing by small firms. Under this method, the **total cost** of the product is first determined. Total cost is the sum of **variable costs** and **fixed costs** that are attributable to one unit of output. A **margin** for profits is then added to the total cost to determine the price. Remember that margin is generally calculated on the selling price. To make the concept clear, an example is given below.

Example

Q) A manufacturer of voltage stabilisers finds that his variable costs per unit of output are Rs. 300/-. His total fixed costs per month, when he is making 100 units per month, are Rs. 6,000/-. What should be his selling price if he wants a margin of 20%?

A) Let us first find out the total cost per unit of output.

Total cost = variable costs/unit + Fixed costs/unit

$$= \text{Rs. } 300 + \text{Rs. } \frac{6000}{100}$$

= Rs. 360 per unit

If the sale price is X, the margin of the manufacturer will be X – 360 (total cost). If 20% margin is required on the sale price, using elementary mathematics,

$$X - 360 = 0.2X$$

$$\text{or, } X(1-0.2) = 360$$

$$X = \text{Rs. } 450$$

Cost-plus method of pricing has certain advantages like 1) the price can easily be adjusted to changes in costs, 2) the profitability of the enterprise is in view at all times, and 3) a sense of cost-consciousness is build up in the operations.

There are some disadvantages also in following this method. It does not take into account many factors like the demand and supply position, and the behaviour of the consumers.

Variable price policy

Under this policy, different prices are charged from different customers depending on the situation prevailing in the market. Some situations under which variable price policy is adopted are :

1) Difference in the size of the customers (e.g. bulk customers may be offered lower price);
2) Difference in the anticipated business from different customers;
3) Difference in the bargaining power of the customers;
4) Difference in the demand and supply position at various locations;
5) Difference in the customers' ability to pay; and
6) Ignorance of the customers.

Some entrepreneurs adopt variable-price policy in their effort to maximise profits. They determine the minimum price to be charged by the total cost of the product, and the maximum price by the customers' ability to pay. Bargaining is usually resorted to in finalising a deal. As such, this policy may be detrimental to the long-term interests of a firm.

Base price and discounts

Under this method, a base price or list price is used and varying price discounts are offered to different categories of customers. Under the variable price policy, the price is changed according to the particular situation. However, under the base price and discounts method, discounts are offered uniformly to all customers and each one of them can avail these on satisfying the stipulated conditions. Discounts are of several kinds. **Trade discount** is given to a trader to cover his costs and provide him with a margin as incentive to deal in the product. **Quantity discount** is offered to bulk purchasers because of their value to the seller. **Cash discount** is given to the customers making cash down or immediate payment. **Seasonal discount** is given to boost the sale of a product during slack season. Electric fans, woollen garments, and cooler pumps are typical examples where seasonal discounts are offered.

Market rate method

Prevailing market rate, many times, is the basis on which an entrepreneur determines the price of his product. If the nature of the product is such that it is largely indistinguishable from those of the competitors, or if it is found that all manufacturers are charging more or less the same price for their products, the market rate method of pricing is usually adopted. In case the entrepreneur finds that the prevailing market rate is not economical for him, he has to lower down his costs somehow rather than increase the price unilaterally. This method is commonly used in case of unbranded products like oils and chemicals, and services like courier, tailoring, and car or scooter servicing. One advantage of this method, especially for new small enterprises, is that they get some immunity from the vagaries of price wars.

Market skimming pricing

Under market skimming pricing strategy, a very high price is charged in the beginning with the objective of recovering the investment in a short period. High price is usually supported by heavy promotion. This strategy is seldom possible except when the product is an innovative one and is expected to command good reception from the customers. One cannot continue with such a strategy for a long period of time as high price acts as an incentive to the competitors to enter the field. The price is permitted to fall as the competition sets in.

Market penetration pricing

Market penetration pricing strategy calls for a very low initial price in order to penetrate into the market. The strategy puts emphasis on creating a mass market for the product even at low margins. This strategy can be adopted when the demand is expected to be price elastic, i.e. customers are price sensitive, and when the economies of large scale production are substantial.

Activity 4

Can you help Mr. Sushil Tandon in working out a price for his coolers? You may make your own assumptions regarding the level of his output, and demand during the season.

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12.6 PROMOTION

We try to influence the customers in favour of our product through various means of communication. These means of communication with customers are commonly referred to as promotion, one of the 4 Ps of marketing mix. There are three promotion tools that are generally available to an entrepreneur; 1) advertising, 2) personal selling, and 3) sales promotion.

Advertising

Advertising is mass, paid communication under clear sponsorship, the ultimate purpose of which is to impart information, develop attitude, and induce action beneficial to the sponsor. One basic purpose of advertising is to increase the likelihood of customers buying the product. Thus, an advertiser may try to inform the potential customers of the benefits that the product offers to them, or remind the existing users of the continued availability of the product. Advertising is also used to perform certain other functions depending upon the specific requirements :

a) To make an announcement of a sales promotion scheme;
b) To expand the distribution network;
c) To counteract the competitors' moves;
d) To build up the enthusiasm of the dealers to promote the company's products;
e) To boost the morale of the sales force; and
f) To boost the image of the company.

Newspapers, magazines, televisions etc., through which we advertise our products are called **advertising media**. There are a large number of media that are available to an entrepreneur as shown in the table below.

Advertising media

Newspapers: National, regional, local, dailies, weeklies etc.
Magazines: General interest (e.g. India Today), and special interest (e.g. Business India).
Trade journals
Television
Radio
Cinema (slides or films)
Video films
Outdoor hoardings, posters, display cards (e.g. on buses), wall writings.
Handbills in newspapers (used commonly in small towns)
Direct mail
Yellow pages

One or more of these media are selected on the basis of their effectiveness in reaching the advertising message to the target customers. One has to also see the cost aspect. Due to their financial constraints, many small enterprises cannot afford to advertise in national dailies or on television. In fact, if the enterprise is catering primarily to local markets, advertising in such media is ruled out both in terms of the cost and the effectiveness.

The primary purpose of advertising is to sell; an advertisement which cannot move the customer nearer to the act of purchasing is waste of money. An advertisement must, therefore, offer a persuasive and distinctive proposition that is able to attract the maximum number of prospective customers. In the field of advertising such a proposition is called a **Unique Selling Proposition (USP)**. Thus, USP is a specific proposition in an advertisement that is unique and distinctive, and is strong enough to pull over new customers to the advertised product.

USP determines what is to be said in an advertisement. The next step is to determine **how** it is to be said. An advertisement has to fight for getting attention in a crowd of numerous other advertisements that a consumer comes across each day. The message, therefore, needs to be presented in an interesting and effective manner. Creativity and judgement play an important role in making a good advertisement. A checklist to assess the soundness of an advertisement is given below:

1) Does the advertisement place emphasis on the right things?
2) Is the presentation persuasive?
3) Is the advertisement interesting to read?
4) Is it easy to read?
5) Is it able to draw attention?

Personal Selling

As against mass selling (advertising), personal selling is man-to-man selling and, therefore, involves a two way communication process between the buyer and the seller. Personal selling is more flexible than advertising as the method of persuation can be moulded according to the needs of the particular customers. Personal selling performs several functions in the marketing of a product;

1) Order booking
2) Enquiry generation
3) Technical assistance to the customers
4) Providing efficient service to the customers
5) Price negotiation
6) Collection of payments
7) Collecting market information

The exact nature of the functions to be performed in each case will depend upon the nature of the product to be sold, and the role that has been assigned to personal selling in the marketing mix of the firm. Personal selling method is extensively used for selling industrial products, and consumer durable products. In case of consumer non-durable products, the role of personal selling is predominantly to meet the requirements of the trade.

Salesmen in different companies differ widely in terms of their education, skills, and salaries. This is quite natural since different qualifications and skills are required to sell computers, and nuts and bolts. Still, there are some characteristics that distinguish a good salesman from an ordinary one :

Thorough knowledge : A salesman must have good understanding of his product, its applications, special features, and the competitive situation. This understanding will enable him to deal with the customers confidently.

Preparation for each visit : A good salesman plans his visits properly and makes preparations for them. Previous appointment is helpful in eliciting positive response from the customer. All the relevant information and back-up material should be readily available with the salesman.

Empathy : Empathy means the ability to feel — intellectually and imaginatively — as the customer does. Selling involves the matching of the interests of the buyer and the seller. No salesman can hope to be successful if he doesn't see and appreciate the viewpoint of the buyer. Listening, therefore, is as important in personal selling as talking.

Trustworthiness: A good salesman generates confidence in the customers through fair dealings, helpful attitude, and honouring his commitments. Developing trustworthiness takes a long time but the rewards are also long term.

Dynamism : By dynamism is meant positiveness, open-mindedness, and purposefulness. It does not necessarily mean aggressiveness or hard selling. A dynamic salesman is not unduly perturbed by the fear of rejection or failure which is so common to personal selling.

Sales Promotion

Sales promotion consists of those promotional activities which are designed to stimulate the sale of a product by offering some kind of incentives. The incentives may be directed towards the consumers, trade, or sales force. While advertising usually offers a reason to buy, sales promotion offers an incentive to buy. The incentives are usually for a short duration of time.

There are a large number of sales promotion tools or methods. Some important sales promotion tools that are directed toward the consumers and the trade are given below.

Directed toward the consumers :

Price-offs: A discount in price for a specific period.

Samples : Distribution of free or subsidised samples.

Premiums : Offer of an article (e.g. a spoon) along with the product.

Quantity-offs : Offering more quantity of a product at no extra cost.

Coupons : These entitle the bearer to a stated saving on the purchase of the product.

Cash-refund offers : These are like coupons except that the refund is made after the purchase rather than at the time of purchase.

Contests : The consumers are invited to participate in contests or campaigns and a few are given prizes.

Directed toward the trade :

Buying allowances : Special discounts offered to the trade for buying large quantities.

Free goods : A specific quantity is given free along with an order (e.g. one bottle free with each dozen).

Display goods : Special displays, racks, banners etc. distributed free to the dealers.

Advertising allowance : A part of full expenditure incurred on advertising by dealers is reimbursed.

Dealer sales contests : The dealers are invited to participate in sales contests and win prizes.

Dealer gifts : Useful and attractive articles are presented to the dealers as gifts.

Dealer conferences : Meetings of the dealers are arranged in expensive hotels with the dual purpose of discussing marketing aspects, and build up their enthusiasm for the company.

Activity 5

Formulate a promotion strategy for Sushil Cooler Co. Assume that the total budget available is Rs. 50,000.

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12.7 PLACE (DISTRIBUTION)

A firm has the responsibility of making its product available near the place of consumption so that the consumers can easily buy it. The consumers may be scattered in large geographical areas and it may be difficult, if not impossible, for the firm to reach them on its own. Many times, the nature of the product is such that the consumers are not ready to wait and would buy any brand that is readily available at the retail shop.

Because of these factors, most producers use marketing **intermediaries**, like wholesalers and retailers, to reach their products to the ultimate consumers. These intermediaries are independent organisations. A set of intermediaries that is used to move a product from the producer to the consumer is known as a **marketing channel.**

Three basic alternatives are available to an entrepreneur as regards the channel of distribution.

Manufacturer → Consumer

a. Direct selling

Manufacturer → Retailer → Consumer

b. Through retailers

Manufacturer → Wholesaler → Retailer → Consumer

c. Through wholesalers and retailers

Fig. 12.2 Marketing channel alternatives

Slight variations of the above channel alternatives are often encountered which are mostly the characteristics of particular industries. Intermediaries like commission agents, brokers, export houses, and super bazars are also used. An entrepreneur should consider the following factors while choosing a particular channel of distribution:

a) Financial implications
   - initial investment in facilities
   - working capital requirement
   - long run growth plans

b) Control aspects regarding
   - selling price
   - promotional efforts at points of sale
   - kind and quality of display
   - points of sale inventory
   - geographical coverage
   - customer service

c) Competitive practices

d) Consumers' and retailers' purchasing habits.

Place (Distribution) also encompasses activities pertaining to physical distribution of the product. Decisions regarding location of warehouses, inventory levels at various points in the marketing channel, mode of transportation of goods, routing of despatches, size of shipments, and bulk packaging have to be taken under physical distribution. All the above decisions can have considerable implications on the firm's cash flow and profitability.

Activity 6

Do you envisage any role for intermediaries in the marketing mix of Sushil Cooler Co.? Please suggest a suitable channel of distribution.

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12.8 SUMMARY

Inspite of great amount of heterogeneity in the market-place, groups of customers called market segments, can be identified which share certain common characteristics of relevance to the firm. The identification of target market segments helps in fine tuning the marketing efforts to the requirements of the customers, and in reducing wastages. Geographic, demographic, and psychographic variables are commonly used as bases for segmenting a market.

There are a large number of decision areas in marketing. Most of these pertain to four basic elements of marketing mix viz. product, price, promotion, and place (4Ps). A marketer is always in search of a well-knit marketing mix that has good consistency within its elements. Product decisions include decisions on the product mix, product attributes, packaging, and branding. Pricing decisions are quite complex and have substantial bearing on the profitability of the firm. One basic decision in pricing is to determine the price of the product. Promotion encompasses decisions on advertising, personal selling, and sales promotion. The role to be assigned to each one of them has to be determined depending upon their utility in a particular situation. Place will include decisions on marketing channel, and physical distribution.

12.9 FURTHER READINGS

Jain, Vijay K. (1988). *Marketing Management For Small Units,* Management Publishing Co.

Kotler, Philip (1988). *Marketing Management : Analysis, Planning, Implementation and Control,* 6th ed., Prentice Hall of India Private Ltd.

McCarthy, E.J. and Perreault, W.D. Jr. (1987). *Basic Marketing,* 9th ed., UBS India.

McCormack, Mark H. (1987). *What They Don't Teach You At Harvard Business School,* Fontana/Collins.

UNIT 13 ORGANISATIONAL RELATIONS IN SSE

Objectives

After going through this Unit you should be able to:

- explain the importance of personnel relations in SSE,
- outline the reasons for the neglect of human factor,
- describe the nature of Human Resource Planning,
- explain the recruitment process,
- identify the steps in selection process,
- recognise the need for training and development,
- list the benefits and services offered,
- bring out the relationship between working conditions and personnel relations,
- explain the process of handling grievances,
- Suggest measures for improving personnel relations.

Structure

13.1 INTRODUCTION

Efficient management of human resources is an important factor in determining the growth and prosperity of business enterprises. This is particularly true in the case of small industry where the owners are forced to have a close and more personal association with their employees. For a large scale organisation, the untimely loss of an employee can be frustrating, but for a small firm it can be devastating. Key and important people in small firms are likely to assume more responsibilities than they do in a large scale organisation. Improper handling of human resources through defective and haphazard personnel policies may compel a small firm to be satisfied with less qualified and less efficient workforce. Personnel and employee relations are too serious to be wished away through fanciful thinking and haphazard actions. In order to build up loyal, efficient and committed workforce, small business owners must pay adequate attention to hiring, training and employee development activities and undertake systematic human resource management practices on a long term basis.

13.2 HUMAN FACTOR IN SMALL INDUSTRY

Many small business owners are not good at handling employee relations for a variety of reasons :

Ignorance : They simply do not know what is involved. The personal function is often looked down upon as an unnecessary and useless activity. The fact that workers are critically dependent on the owner for their survival and continuance in the small business, compels many to think that investment in personnel work is unnecessary and unwarranted.

Small Size : Many small business people feel that their firm is too small to have human relations problems; they feel, because the firm is small they can be in touch with their employees daily and eliminate their problems. They feel their informal, open-door policy will alert them to any serious personnel problems; or that they possess the insights needed to hire the kind of employees who never create personnel problems.

Little Time : Many small business owners are constantly haunted by financial and marketing problems. Factors such as cut-throat competition, market fluctuations, governmental interference, compel owners to preoccupy themselves predominantly with production-finance-and-marketing problems daily. In the unhealthy race for capturing a fair share of the market they tend to view the problems that surface and occur with increasing frequency as crucial, discounting in the process, the vital issues that flow beneath the carpet. The human element, which is so essential for oiling the wheels of progress and putting the industry on the right track, is completely ignored. The fact that workers are unorganised and illiterate also encourage them to conveniently think that personnel issues are postponable things. The chronic absence of national, industry and plant unions in the small scale sector also add to the situation. The poor bargaining strength of the workers injects a false sense of strength in the minds of owners and, not unreasonably, the need for striking a harmonious balance between owners and employees through good human resource practices is never realised.

Small scale sector has registered tremendous growth in recent times. The days of the owner-managed firms enlisting the services of family members have gone. Now-a-days, most firms are set up in industrial estates by qualified, educated and trained entrepreneurs. Thanks to the governmental support, the size of the firm tends to be large. The entrepreneurs are conscious of the fast developments in science and technology and the growing demands of a modern organisation. The dangers of 'in-breeding' and 'family-house-keeping' are realized by every forward-looking entrepreneur and, consequently, the services of technically competent people are sought after in an attempt to manufacture high-quality products. In the absence of wholehearted support and high-quality contributions from labour force, small industry cannot flourish. The growth of employment in small industry and the growing dependence on skilled labour force necessitates the adoption of scientific techniques for managing people. Human Resource Management (HRM) with its emphasis on fair treatment and employee development enables small business managers to manage their human assets effectively and efficiently.

Activity 1

Visit an entrepreneur who is in a manufacturing business and another who is in retail business.

a) What sort of employee relations problems do those entrepreneurs have?

b) How do these problems differ?

c) What are the coping mechanisms that these entrepreneurs use?

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13.3 HUMAN RESOURCE MANAGEMENT IN SMALL INDUSTRY: STUDIES IN INDIA

Human Resource Management is the function performed in organisations that facilitates the most effective use of people to achieve organisational and individual goals. It is the use, development, assessment, reward and management of employees or worker groups in an organisation. Unfortunately, while there is much literature dealing with problems of production, finance and marketing in respect of small-scale industries, not much attention has been paid to personal problems. A few studies made so far have examined only peripheral issues like the extent of self-employment, working conditions and wage structure, labour relations etc. A comprehensive study examining all important personnel problems was, however, missing till recently, as shown in Table 14.1. The studies made after 1983 have, more or less, tried to bridge this gap by exploring the personnel problems in small industry in detail. In the light of these studies, let's examine how personnel work is actually carried out in small industry.

13.4 HUMAN RESOURCE PLANNING (HRP)

Human resource planning is one of the most frustrating situations which the typical small business owner will encounter. Perhaps the reason is that the small firm is not big enough to hire the exact type and number of people needed. Typically, it lacks facilities for properly recruiting, selecting, developing and utilizing its personnel. Lack of economies of scale so far as record keeping and administration of a systematic personnel programme may also exist. One disgruntled person represents a much larger percentage of the total workforce in the small firm than in the larger one. Therefore, it is important for the small business owner to try to keep from hiring the wrong employee. In actual practice, however, the process of getting the right of number of qualified people into right jobs was thoroughly discounted. Lack of adequate resources for initiating systematic personnel programmes was the reason cited by employers in Kurnool and Visakhapatnam studies. In most cases owners were compelled to succumb to the pressures brought in by relatives and influential personalities, i.e., DIC officials, Factory Inspectors, Excise Collectors, Managers of Banks and financial institutions while manning their 'key' positions.

Table 1 Personnel Issues in Small Industry : Studies in India

Author/Organisation	Year	Place	Issue Examined
Zacharaiah	1954	Bombay	Industrial relations & personnel problems
Balgit Singh	1960	Moradabad	Working conditions & Wage structure
UNESCO Research Centre	1966	Rajkot Delhi Hyderabad Ludhiana	Working conditions & Union relations of workers in small industries in four major cities
Ramakrishnan	1975	Delhi	Labour-management relations of workers
Hein Streefkerk	1981	South Gujarat	Wage structure & living conditions
Kalpagam	1981	Madras	Wage structure & living conditions
Mehta	1981	Adityapur	Labour relations in small firms
Munshi	1983	Saurashtra	Personnel Problems of Non-supervisory employees
Subbarao	1983	Eluru	Personnel Management in Industrial Estates
Gupta	1984	Kanpur Allahabad Gorakhpur	Personnel Management in Small Units
Apparao	1985	Kurnool District	Personnel Problems in Small Scale Industry
Suryaprakasa Rao	1987	Visakhapatnam	Human Resource Management in Small Industry

In the face of these mounting pressures, the decision making capabilities of owners are watered down and they are forced to accommodate 'misfits' in their organisations.

The recent developments in small industry such as modernisation, increased competition from large scale units and the resultant need to maintain quality and precision in their products, the availability of jobs demanding specialised skills (for instance, electronics and engineering sectors) demand a serious rethinking on the part of owners with regard to Human Resource Planning in the years ahead.

13.5 RECRUITMENT

Recruiting is the process of generating a pool of qualified applicants for organisational jobs. Recruiting employees is more difficult for a small business because such a business cannot compete with large companies in salary, fringe benefits, and apparent stability. Potential employees often do not see the opportunities for advancement that exist in the small company, and they may have doubts about the future of the business. By paying wages comparable to those offered by large units and by stressing promotional opportunities or a better chance to learn the business, however, the small employer can largely offset this handicap. Aggressive solicitation and image building the company by the small businessman can further lesson some of these limitations and help to secure an adequate supply of the right type of job applicants. He should strive to create a public image of his plant as a 'good place to work'.

Another prevalent practice in the small business is to seek out and select candidates rather than wait for applications. Perhaps the best source of manpower is the friends and relatives of present (satisfied) employees. Company's customers and suppliers, teachers, local leaders, trade associations and educational institutions can also be solicited for their help in locating prospective employees who possess desirable skills or personality traits. In any case, when applications for employment are received, standard employment procedures should be followed, though perhaps more informally in the small business than in the large one.

Small business owners, recognizing the problems of competing with large companies, should use every resource available to attract competent people. However, this is easier said than done. In actual practice, as the following studies indicate, the small business owners have not tried many of the job-search-methods that are popular with large scale units.

Table 2 Recruitment Sources in Small Industry : Studies in India

Sources of Recruitment	Research Study
Kinship, friendship and village ties played a major part in the recruitment process	M.N. Srinivas, A Sociological Study of Okhla Industrial Estate, Delhi, 1962.
Direct as well as indirect recruitment methods used depending on convenience and expediency	S.V. Ayyar, Social Implications of Small Industries in Hyderabad – Secunderabad, 1963.
Caste and Communal loyalty played a major part in recruitment	S.B. Rangnekar, Social and Economic Aspects of Small Industries in Ludhiana, UNESCO Research Centre Publication, 1962.
Direct requests from candidates, intermediaries, advertisements played a major part.	Hein Streefkerk, "Too Little to Live On, Too Much to Die On" Economic and Political Weekly, April, 1981.
Occasional advertisements, gate hiring, kinship ties played a major role in recruitment	Shashi Bala, Management of Small Scale Industries, Deep, and Deep New Delhi, 1984.
Friends, relatives, recommendations from influential persons played a major part in recruitment process	N.M. Munshi, Personnel Management in the Units of Small Scale Industries of Saurashtra Region, 1983-84.
67 per cent of employees through personal sources and 33 per cent through employment exchanges (Total workers : 1236)	M.C. Gupta, Entrepreneurship in Small Scale Industries, Anmol Publications, New Delhi, 1984.
Personal contacts, employee referals and recommendations of local leaders played a major role in the recruitment process	P.B. Appa Rao, Personnel Problems in Small Scale Industry, Doctoral Thesis, Anantapur, 1985.
Pre-employment acquaintances, casual callers, gate hiring major factors in recruitment	V. Suryaprakasa Rao, Human Resource Management in Small Industry, Discovery, 1990.

Activity 2

Take a sample of 10 small scale industries. Discuss with the employers to find out:

a) What were the sources of recruitment they used.
b) Do these sources vary over type of job.
c) Can you suggest some alternative and suitable recruitment sources to these entrepreneurs.

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13.6 SELECTION

The selection decision is considered to be one of the most important in the entire personnel process. It is at this point the small business manager makes very crucial decisions regarding his manpower. A poor decision or one made in haste at this juncture may mean untold expenses and emotional hardship for both the individual and the organisation. Since the basic purpose of selection is to find out right kind of people to fill the available positions, an orderly and systematic procedure is always advisable, irrespective of the size of the organisation. While the policies and practices in regard to selection will naturally vary from place to place and agency to agency, it is possible to identify certain common principles and objective practices which, if followed, would go a long way in ensuring open and fair selection. Small business owners can prevent many unpleasant situations if they do not attempt to short-circuit the selection process. In most cases, it is equally as poor a policy to select somebody who is over-qualified as one who is under-qualified for a position. Employees whose talents remain under-utilised on the jobs get frustrated quickly and the turnover rate inevitably would be high. Under-qualified persons get frustrated, too, because of the lack of skill or knowledge and the job performance would be inferior inviting the indignation of the employer frequently. Thus, selection is a critical function in the personnel relations in every way.

The selection devices can be grouped into four categories : the application blank (which provides pertinent personal information, educational and experience qualifications, work history and references), the interview (used to estimate the applicant's personality and attitudes), various tests and examinations (to find out the applicant's proficiency, skills, aptitude, vocational interests, and other job-related capabilities), and checks of individual's prior work record. Though these techniques have been available to owners of small scale units for decades, they are seldom put to use sincerely. They are, often, misunderstood, slighted away or dispensed with altogether. The time and expense involved seem to be too prohibitive. Employers also presume that elaborate selection techniques could not be employed in small scale units for a variety of reasons, and in most cases, employer's own judgement would help them make a wise choice. As the studies have indicated, the small business owners feel that the various kinds of selection tools that are commonly employed in large units cannot be used in small companies because of:

- paucity of funds
- interference from friends, relatives, local leaders
- shortage of time
- non-availability of people possessing requisite skills etc.

In view of the time and money involved in following a multi-step process for selecting suitable candidates, the small business owners must try to follow an informal approach screening the applications and interviewing the candidates carefully.

Placement

Once a new employee has been selected, the employer must not expect him or her to take over the job operation without additional help. Among the common mistakes made by the employer are: i) not allowing enough time for training, ii) not providing close supervision under actual working conditions, and iii) expecting too much in too short a time. As we all know, the first few days in a new position are usually the hardest. A newcomer should be introduced to his fellow workers, shown the location of employee facilities, informed of any regulations, and encouraged to ask for additional information as it may be required. A good plan is to assign an older, more experienced worker to act as sponsor until the introductory period is over.

The 'owner' himself should follow on the new employee by occasional visits with him until he or she feels at home in the organisation. Consideration and reasonable attention at this time are a good investment in personnel relations.

13.7 TRAINING AND DEVELOPMENT

Training may be defined as 'any procedure, initiated by the organisation, which is intended to foster and enhance learning among organisational members'. In a small scale unit the owner has the responsibility for developing and conducting the training programmes, aimed at providing opportunities for employees to acquire job-related skills and knowledge. The training may require a few hours, a few days or even a few weeks or months, varying with the nature of work and the previous training or experience of the employee. Some types of training available to employees are discussed below:

On-the-job-training (OJT): On the job training is the most practical and most often used training technique in the small business. It consists of the employees receiving training while they perform their regular jobs. Thus, they are both producers and learners. An effective programme consists of these steps:

- The job is demonstrated to the employees and each step of the process is explained thoroughly.
- The trainees perform the task by applying what they have learned in step one.
- In the third step, the work is inspected and immediate feedback of the job performance is given to the trainees.

Apprenticeship Training: Apprenticeship training is a formal type of training that combines both formal classroom learning and on-the-job experience. This kind of training programme is provided mainly in the skilled trades—plumbers, electricians, bakers.

Job Rotation: Particularly in the small business, it is helpful if each employee has a good understanding of the different functions performed in the firm. In this way, if one employee is absent, another employee can fill in. One way to accomplish this objective is by rotating employees from job to job for a few hours a day, a few days or several weeks depending on the difficulty of the task.

Outside Training: Outside training consists of the employees being trained at schools/institutes outside the company. This is relevant in areas like computer training; training for a particular liable etc.

Training is a continuing part of the employee development process. Periodic internal training sessions, coaching on the job, attendance at manufacturer and distributor sponsored courses, and seminars and formal courses provide additional training opportunities. A reasonably stocked library of books on pertinent business and technical subjects related to the small firm in question is a good training resource. By speaking enthusiastically about the books and by encouraging employees to check them out and use them, the owner can give an 'extra push' to training efforts at low cost.

Training Function in Small Industry

Contemporary studies clearly indicate the fact that the training function is the most neglected one in small industry. The training, wherever it is given, is mostly on the job variety and owners are not enthusiastic about sending their employees for outside training. Training period does seem to be pretty long, considering the nature of work handled by trainees, and though the trainee has learnt the intricacies of the job, he is often made to work with meagre payments. The training opportunities for both skilled and unskilled employees were either absent or very few. The following table reveals the picture more clearly (Table 3).

Table 3 Training Function in Small Industry : Contemporary Studies in India

Aspects of Training	Shashi Bala Ludhiana	Munshi Saurashtra	Apparao Kurnool	Suryaprakasa Rao Visakhapatnam
1) Coverage and number of people for which training offered	Skilled and Unskilled Selected ones only	Skilled and Unskilled Selected ones only	Skilled and Unskilled (selective)	Skilled and Unskilled (selective)
2) Nature of Tg.	On the job minimal	On the job informal	On the job plus apprenticeship; minimal & informal	On the job plus apprenticeship; formal as well as informal
3) Period of Tg.	Unspecified	Unspecified	3 to 12 months	2 to 6 months
4) Payment during training period	Low wages	Paid very little	Nominal wages	Low wages paid
5) Outside training	Not offered	Irrelevant Costly Unnecessary	Not offered	Not offered

Unfortunately, many small business owners tend to overlook training function and take too much for granted. As the studies have pointed out, the owners complain about the expenses involved in imparting training to their employees on a continuous basis. They also resent the consequent dislocation to their production schedules. Sometimes, the fear that the trained would not stay on the jobs for long, also acted as a deterrant. Again, after receiving training, employees may demand more wages, and if these are not met, they may quit the jobs. Such psychological fears and emotional objections have prevented many a small business owner to undertake systematic training programmes for their employees or send their employees for receiving training from outside institutes.

In India the various training programmes for operations, supervisors, managers and proprietors of small enterprises are designed by the Small Industries Development Organisation (SIDCO), National Small Industry Corporation (NSIC) and Small Industries Extension Training Institute (SIET). The National Institute for Entrepreneurship and Small Business Development (NIESBUD), New Delhi, co-ordinates the training and research activities for entrepreneurship development in small industry. Other central institutes like Prototype Development and Training Centres of the NSIC; Central Institute of Tool Design (Hyderabad), Institute for Design of Electrical Measuring Instruments (Bombay), Central Tool Room and Training Centres, Ludhiana and Calcutta; Central Institute of Hand Tools, Jalandhar; National Institute of Foundry and Forge Technology, Ranchi; Central Institute for Plastics, Engineering and Tools, Madras; also provide specialised training to technical personnel engaged in specific small scale industries. To supplement these, State Governments have also started training centres, tool room and testing facilities in various parts of the country.

Activity 3

a) Visit the nearest Small Industries Development Organisation (SIDO) or Small Industries Executive Training Institute (SIET). What are the training needs of the Small Enterprises as identified by these institutions. What are the kind of training programmes undertaken by them to fulfil those needs.

b) Visit the industrial area and discuss with some small entrepreneurs to find out about the training needs of their employees. How well does the assessment of the above institutions match that of the entrepreneurs.

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Developing Employees

The concept of starting at the bottom of the ladder when one is young and rising in status and income as one grows older is deeply embedded in our culture. Development is concerned with the growth of an employee in all respects. Promotions, job rotations, special training courses, etc. are designed to develop employees while at work. Unfortunately, a large majority of the small scale units are characterised by low-ceiling jobs, where there are limited opportunities for significant progression. They are flooded with a vast army of plateaued personnel who have temporarily or permanently stopped at their career paths. In the absence of vertical mobility, not surprisingly, many employees tend to get frustrated and perform much below their capacity. Since promotions are virtually unheard of in small industry, the dearth of research effort in this area is not a surprising thing. In the Saurashtra study also, only three units out of 150 had arrangements to promote employees to higher positions. The Kurnool and Ludhiana studies had ignored the subject altogether. In the Visakhapatnam study majority of the units did not have any promotional avenues for the employees. Even when promotions are granted, they are products of merciful giving and adhocism on the part of the owners. Lack of meaningful promotional avenues, thus, is a characteristic feature of small industry in India. This handicap, however, can be turned into an advantage by stressing the greater range of training and experience to be secured by employment in the small unit. The owners can make this appeal to men who later hope to enter business for themselves.

13.8 REMUNERATION AND BENEFITS

In the organised sector, the worker is not satisfied with the wages he receives. He expects to be protected against the galloping inflation. He wants to improve his standard of living by sharing in the gains of economic progress in the country. He is politically awakened and is ready to protest to secure his rights. In the unorganised and small scale sectors however, the situation is really pathetic. Wages in these sectors are round one-half of those in the organised sector though labour productivity does not differ between them significantly. Often, high wages in the organised sector have been described as 'islands of prosperity' when compared to the poor wages or 'oceans of distress' in the small scale sector. The low level of productive efficiency and morale of employees in the small scale sector is often attributed to this factor-dissatisfaction with wage levels.

An equitable and competitive wage and salary plan is therefore, essential in the small business. Paying lower wages or salaries than is paid employees of another companies in the area is certain to increase employee dissatisfaction and increases the chances of losing key employees. The earnings of employees must be high enough to motivate them to be good producers, yet economic enough for the owner to maintain a satisfactory earnings level.

Wage Fixation in Small Industry

In small industry a considerable amount of guesswork and arbitrariness creep into the wage determination process. Because of his complete dependence on employment for his livelihood, a worker is compelled many a time to live with wages that would cover only subsistence needs. Wage fixation is done on an ad hoc basis and though the workers are painfully aware of the wage differentials that exist even for similar comparable jobs inside an organisation, their poor bargaining strength does not permit them to voice their concerns in an organised and vociferous manner. As a result, there has been a heterogeneous growth of wages in different small scale units for the same skills. The problem is also aggravated by the limited financial potency of small scale units to offer fair and satisfactory wages to their employees. Their vulnerability to market fluctuations, too, does not permit them to base their compensation plans on well-established norms and principles, i.e., equal pay for equal work, ability to pay, cost of living index etc. Thus, wage determination process in small industry presents interesting paradoxes: while the workers' aspirations are unlimited, the employer's ability to pay is limited; while some employees are greeted with fair compensation plans others are not; while some industries follow the rates in the industry others do not. In the Saurashtra, Kurnool and Visakhapatnam studies owners have considered factors such as job difficulty, amount paid in similar units, ability to pay etc. while fixing wages for skilled employees. In respect of unskilled employees, mostly it was a product of negotiations between the individual employee and the owner. Payment by time was mostly followed. Increments, however, were not granted to employees regularly. Inter-industry and inter-unit wage differentials existed.

Benefits and Services

In addition to compensating employees fairly and adequately for their contributions in the performance of their jobs, organisations these days, typically pay for a wide variety of supplementary items—often called 'fringe benefits'. Broadly speaking, these may be classified into four groups; premium payments consisting of bonus and overtime; payments for time not worked consisting of payments for rest periods, holidays, vacations and leave; payments for employee welfare covering medical, provident fund and gratuity; and payments for employee services such as housing, conveyance, loans and advances, canteens, etc. Let's examine how these benefits and services are extended to employees in small industry, based on the evidence from the research studies cited in previous sections.

Bonus : The Payment of Bonus Act, 1965 applies to every factory and to every other establishment employing 20 or more persons. The latest arrangement is that bonus must be paid at a minimum of 8.33 per cent of annual wages to all employees drawing wage/salary up to Rs. 2,500 p.m. A minimum of 30 days' working in a year qualifies an employee for bonus payment. The fact that the Act applies to only those establishments where 20 or more persons are employed has put employees in small industry at a considerable disadvantage. Often, employers do not register the names of their employees on the payroll to avoid legislative provisions. The employees in small industry also suffer because of the absence of unions, bargaining with employers in an effective manner. Employers were of the opinion that a small scale unit cannot afford to pay bonus as per the legislative provisions.

Overtime : The Factories Act, 1948 stipulates that if a worker works in a factory for more than nine hours in any day or for more than 48 hours in any week, he shall in respect of the overtime work be entitled to wages at the rate of twice his ordinary rate of wages. The evidence from research studies is, somewhat, depressing, as most of the employers did not pay overtime as per the legislative provisions. Employees were paid at ordinary rate, i.e., normal wages. There were also instances where the employers, have not paid overtime even at ordinary rate; instead, they simply gave workers a cup of tea or food. Earlier studies on administration of Labour Laws in small firms also pointed out that 'violation of labour laws in small industry is easy and natural and in many cases, it is even cheaper'.

Payments for time nor worked : Paid benefits for time not worked on the job include rest periods, lunch periods, wash-up time, clothes-change and get-ready times. Employees in small industry were given a rest pause consisting of 30 to 60 minutes tenure. Apart from weekly off days amounting to 52 annually, employees were also allowed to go on leave subject to a maximum of 10 days in a year. The provisions of the Factories Act, however, were not observed.

Welfare payments : The Employees State Insurance Act, 1948 is applicable to all factories using power and employing 20 or more persons whose monthly wages does not exceed Rs. 1,600. It provides for free medical treatment in case of sickness and employment injury, free maternity care for women employees, cash disablement benefit in the case of employment injury and pension for family or dependents of deceased in the case of death. However, actual experience showed that most small business owners did not provide medical benefits to employees, observing these provisions. In case of employment injuries, too, employers did not offer any compensation. Such cases were 'hushed up' and not reported. The ESI dispensaries were operated either without medicines or doctors. The provisions of the Provident Fund Act, 1952 and the Payment of Gratuity Act, 1972 were also thoroughly discounted.

Payments for Employee Services : Employees in the small industry received loans and advances from employers on festive occasions like Diwali, Dussehara, Pongal, etc.

Housing and conveyance facilities were, however, not extended to them. In view of the paucity of funds, limited scale of operations in the small industry, the benefits offered by small business owners do not seem to be worthy of special mention. However, unless employers extend these benefits and services to their employees, personal relations in small industry cannot be improved in a significant manner.

Activity 4

a) With respect to the sample that you choose for Activity 2, find out the type of benefits and services received by the employees of those enterprises.

b) Do these benefits differ over type of enterprises? How?

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13.9 WORKING CONDITIONS AND PERSONNEL RELATIONS

Human beings are complex in their mental make-up and, hence, small business owners howsoever close they might be to their employees, cannot influence employees' inner states directly. They can, in any case, create pleasant working conditions with a view to improve personnel relations in their units. Unfortunately, wherever the studies have been carried out, most small business owners did not pay much attention to this aspect. Operations involving removal of dirt and refuse from the floor and benches of work-rooms, cleaning of floor daily, waste disposal were most unsatisfactory. The factory rooms had very low ceiling and workers had very little room for free movement inside the factory premises. They were housed in filthy work environments and owners did not take any steps to prevent inhalation of dust/fume by employees. Most units were noise-prone and suffered from inadequate illumination. The provisions of the Factories Act with regard to maintenance of latrines and urinals, drinking water, rest and dining rooms were also conveniently ignored.

The small business owners must realise the importance of providing safe, pleasant and comfortable work environments inside their organisations before expecting meaningful contributions from employees. When working conditions are satisfactory, employees tend to have good relations, their attitudes towards work improve and they tend to produce more. A number of research studies have confirmed this fact. In order to develop a healthy work climate, it is therefore essential to create pleasant working conditions in small factories as well.

13.10 RELATIONSHIPS WITH EMPLOYEES

The approaches to working with and through people are myriad. However, in view of the close personal contact between employer and employees in the small industry, the approaches to leadership and motivation tend to get clouded by informal relations. The old hard-line autocratic "Do it now" approaches do not produce results in a satisfactory manner. The small business manager must, therefore, visualise the importance of taking employees into confidence in running the show and encourage them to participate in all important decisions affecting their work lives. He can earn respect from employees if he:

- treats employees fairly
- works with reasonable moral standards
- respects employees showing promise
- allows employees to participate in important activities
- communicates with employees in a simple and straight forward manner
- motivates employees through financial as well as non-financial rewards
- handles complaints and grievances from employees in a sympathetic manner.

(Forrest H. Frantz, Successful Small Business Management, Prentice Hall, 1978 Chapters 13 and 14 : Management and Human Resources)

Handling Employees' Grievances

An axiom in all personnel relations is that most major troubles result from neglected minor grievances. Complaints and grievances will inevitably occur in small businesses as well. The small business manager should encourage employees to ventilate their grievances openly, freely and frankly. He should be aware of the fact that workers will be usually reluctant to talk about their 'gripes' with 'higher-ups' unless they are encouraged to. Therefore, an assurance to employees that expressing their complaints will not prejudice their relationships with their immediate supervisors must be given initially.

Huge enterprises have organized systems to secure and use employee complaints for better employee relations. The small businessman who relies solely upon his 'close personal contacts' in this area is courting unnecessary risks. He has the following avenues to use in arriving at the best solution to this problem.

- A clear method from the employees' view point of presenting their grievances, and a description of how those complaints will be processed.
- A minimum of red tape and time in processing their complaints and determining a solution.
- An alternative approach of communicating with employees who cannot express themselves well to present grievances.

Unresolved grievances can lead to strikes. The small businessman should, therefore, listen patiently and deal with a grievance promptly even when he believes that the grievance is without foundation. He should thank the employee for bringing the grievance to surface. Before rendering judgement on the grievance, he should think about it carefully and gather pertinent facts. In this regard he can use the exit—interview techniques—that is, find out from each employee who quits just what his complaints about the company were. He can also institute a continuous plan of employee suggestions with frequent conferences and requests for ways in which the firm can improve employee relations. The small businessman has the big advantage of being able to establish a close bond of confidence and trust with his employees if he will take the initiative in doing so. More importantly, he should inform the employee of his decision on the grievance and flow up later to determine whether the cause of the grievance has been corrected. He should also maintain written records of all grievances in employees' files. These records are beneficial in his defense against any charges of unfair labour practices which may come up later on.

Dealing with labour unions

Many small business managers have rather strong personal anti-union feelings because they believe : i) they have made it on their own, and employees want to take it away from them; and ii) an individual's drive and initiative are more productive than group-set norms. This partly explains why unionism in small industry is not widespread. Apparao's study on personnel problems in small industry also indicated how the rigid attitudes of employers came in the way of formation of unions in small industry and how employees are victimised consequent to their joining unions. This has been confirmed in the Visakhapatnam study too. Interestingly, these studies have also indicated the fact that given the opportunity, majority of employees in small industry would like to join unions. Against this background, we can safely conclude that there are two options before the small business owners now : i) avoiding unionisation. ii) accepting unionisation as a necessary part of business activity.

If the small businessman wants to avoid unionisation, he must understand the forces that drive employees to seek a union and through proper management prevent these forces from developing. Employees usually want unions for some quite clear reasons: to get better pay, to have job security, to gain means for recognition and to be protected from unpredictable behaviour of the boss. These forces clearly indicate the steps the small business owner must take in order to avoid unionisation, i.e., fair wages, continuous employment, reasonable hours of work, pleasant and safe working conditions, growth opportunities, fair treatment etc.

Where the company is already unionised, the owner should be prepared for the possibility that certain difficulties may occur. Employees may begin to view the owner more as an economic opponent than as a person with whom cooperation can be expected to obtain mutual benefits. Three essential steps need to be observed scrupulously where the company is unionised, as indicated below :

Preparation : The owner must be ready with facts about wages, hours, working conditions prevailing in various units in the area/industry. Disciplinary actions, grievance handling procedures, and other matters that are brought to the negotiation table currently must also be kept in mind, before undertaking the negotiations.

Negotiation: This is the crucial step in dealing with unions. The owner must realise that anything given up now probably can never be regained. He must, therefore, consider the impact of wages, benefits, services, etc. on the company's overall performance. The union agreement, when executed by both parties, usually consists of the following clauses : union recognition, wages, benefits, working conditions, layoffs and rehiring, management prerogatives, hours of work, seniority, arbitration and renewal clause.

Live with the contract : Once the agreement is signed, the owner should live with the contract until time to negotiate a new one. All the supervisors must also be thoroughly briefed on the contents. Meanings and interpretations of each clause should be reviewed, and the wording of the contract should be clear and unambiguous. More importantly, the company's labour relations and personnel practices should be consistent, uniform in application and interpretation, and based on a sense of 'fair play'.

13.11 IMPROVING PERSONNEL RELATIONS

Small business managers should recognize the uniqueness of their firms. The level of efficiency achieved in the small firm is significantly influenced by the performance of the employees. Unlike a large firm, the small unit with its limited financial resources does not ordinarily employ a personnel specialist. Instead, the owner-manager may take personal charge of the personnel activities or delegate them to an employee who performs them in addition to a regular assignment. Although the personnel management function does not have the status of a full-time manager, it by no means detracts from its importance. In fact, it should signal to owner-managers that they must devote greater energy if the personnel relations have to be developed and maintained in a satisfactory manner. Small business managers can contribute greatly to improving employee relations by being aware of the specific suggestions listed below:

1) Improve your own understanding of general behaviour.
2) Accept the fact that others do not always see things as you do.
3) In any differences of opinion, consider the possibility that you may not have the right answer.
4) Show your employees that you are interested in them and that you want their ideas on how conditions can be improved.
5) Treat your employees as individuals; never deal with them impersonally.
6) Respect differences of opinion.
7) Insofar as possible; give explanations for management actions.
8) Provide information and guidance on matters affecting employees' security.
9) Make reasonable efforts to keep jobs interesting.

10) Encourage promotion from within.
11) Express appreciation publicly for jobs well done.
12) Offer criticism privately, in the form of constructive suggestions for improvement.
13) Train supervisors to be concerned about the people they supervise, the same as they would be about merchandise or materials or equipment.
14) Keep your staff up-to-date on matters that affect them.
15) Quell false rumours and provide correct information.
16) Be fair.

(Martin M. Bruce, Human Relations in Small Business, Washington, D.C. Small Business Administration).

13.12 SUMMARY

The unit deals with the importance of personnel relations in small industry. Factors such as ignorance of the small business manager, small size of business, lack of time, often, come in the way of discharging the personnel function effectively. The small firm lacks facilities for properly recruiting, selecting, developing and utilizing its personnel. Many of the job-search methods that are popular with large scale units are not employed by the small firm; the selection process is short-circuited; training and employee development activities are thoroughly discounted; wage fixation process is undertaken on a subjective basis and the benefits and services offered are, rather, poor. The small firm, too, can have problems with employees. A systematic procedure for handling grievances must be established. Likewise, owners must shed their anti-union feelings and learn to live with unions by executing the contract carefully. Personnel relations can be improved in a small firm by giving meaningful participation to employees in all important matters affecting their working lives.

13.13 SELF-ASSESSMENT EXERCISES

1) What, in your opinion, are the reasons for neglecting human factor in small industry?
2) What does human resources planning entail in the small company?
3) What methods can be used by small business managers in recruiting new people?
4) What steps should you observe in selecting employees in a small firm?
5) Why should personnel development be emphasized in a small firm? Describe briefly the methods of training non-managerial employees.
6) What do you think are the factors that go into the process of wage fixation in small industry? Describe briefly the benefits and services offered to employees in small industry in modern times.
7) How should a small business manager handle grievances of his employees effectively?
8) Why are small business managers' anti-union? Describe the preparation for bargaining with a labour union in the small company.
9) Explain the importance of developing sound policy for personnel matters in a small firm. Suggest measures for improving personnel relations therein.

13.14 FURTHER READINGS

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NOTES

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MBA-3.2

Management of New and Small Enterprises

Block

5

PERFORMANCE APPRAISAL AND GROWTH STRATEGIES

BLOCK 5 PERFORMANCE APPRAISAL AND GROWTH STRATEGIES

After going through the issues related to all the functional areas in a small scale enterprise in the last block, let us concentrate upon issues related to growth performance evaluation and control of small enterprises.

This block consists of 3 units. Unit 14 on performance evaluation and control, highlights the need of evaluation in a small enterprise and discusses the measures and tools for performance assessment and control.

Unit 15 takes you through the stages in the growth cycle of an enterprise and discusses the strategies used during the stabilisation and growth phases.

Family based enterprises occupy a significant place through their prevalence in the SSI sector. Unit 16 discusses the issues, problems and strengths associated with family business in India.

UNIT 14 MANAGEMENT PERFORMANCE ASSESSMENT AND CONTROL

Objectives

After going through this unit you should be able to:

- describe the need for performance assessment and control for a small scale enterprise
- discuss the measures of total performance assessment
- explain the significance of short term and long term measures of performance
- describe and apply the cost and asset performance measures.

Structure

14.1 INTRODUCTION

Small entrepreneurs need to be better managers than large business tycoons. They face, downscaled of course, all the problems of the larger business and have to deal with most of them personally, without the backup of professionally trained staff and far fewer resources. However, better managing yields rich dividends to the small businessman, earnings on assets have typically been found to be higher for the small entrepreneur.

One of the ways to learn to manage better is by measuring our performance constantly as we move ahead, and correct ourselves for errors. This unit discusses some easy to apply performance measures which will help you measure your own performance, make corrections and finally, manage your success.

14.2 A TOTAL PERFORMANCE INDEX

As a small entrepreneur, you are in the market place because you are able to fulfil some unfilled customer needs. The success of your enterprise is therefore measurable by (i) a steady growth of new customers and (ii) a high ratio of repeat customers who sustain the business. Simple monitoring and record keeping will help you keep a track of new and repeat business. With every sale, you know whether it is a new or a repeat customer. Your sales records will let you monitor this information easily. Over a period of time you will get a fair idea of the percentage of customers who contribute to your repeat business as also the rate at which new customers are joining in. A cursory analysis may reveal the following situation.

Table-I

Time period

	1	2	3	4	5	6	7
Average Performance							
New Customers	50	52	54	56	58	61	63
Repeat Customers	0	30	31	33	34	35	37
Total	50	82	85	89	92	96	100

Poor New Sales							
New Customer	50	50	40	45	35	40	30
Repeat Customer	0	30	30	24	27	21	24
	50	80	70	69	62	61	54
Poor Repeat Sales	50	52	54	56	58	61	63
	0	30	26	22	17	11	06
	50	82	80	78	75	72	69

The average performance scene shows a slow but steady growth (around 4%) of new customer and a 60% repeat buying rate. You can imagine the scenario that would exist if both rapid new sales and repeat sales accrue. As it is, the business has attained double the sales in the 7th period as compared to the 1st period.

The second case, poor new sales, still shows a fairly high repeat business rate, but dwindling rates of new business. The cause may be poor promotion, poor location, a new effective competitor joining the market and so on. You must analyse the reason adequately to find out the reasons for lack of growth.

The third situation, poor repeat sales, shows the same rate of new business growth as in the first case but the repeat sales fall continuously from 60% in the first period to 10% in the last. The firm is not going out of business as it is still able to attract new customers, but it is not growing, as the repeat business is not adequate, the reasons may lie in poor product performance or bad after sales or indifferent consumer relations.

As a manager you would need to see both the aspects i.e. growth of new business and an adequate sustenance by repeat business. You must decide for yourself a desirable and attainable rate of new business growth as well as the percentage of repeat business to ensure that you have some steady increase in new customers and are able to retain at least 50% of your buyers as repeat customers. This measure of growth gives you a very general idea of whether you are able to serve your market adequately.

Another overall measure of performance is financial, that of earning on assets which enables you to see if your utilisation and earning of resources compares well with that of your competitors. Your ability to earn on total assets and earn on owners networth are basically survival measures. The first among these i.e. earning on total assets measures your performance in terms of efficiency with which you use all your resources. The second measure, earnings on networth, shows how much gain in wealth you have made. Just suppose you are in the chemicals business and your accounts look like the figures shown below. Let us see how the two figures can be arrived at

Co. ABC List of Assets	Value	Co. ABC Income Statement shows earnings of the firm	
Cash at hand and in Bank	Rs. 20,000	Total Sales and Receipts	300,000
Accounts receivable	40,000	Minimum cost of goods sold	200,000
Inventory	60,000	All business exp.	90,000
Other current assets	4,000	Net Profit (before taxes)	10,000
		Plus Interest	10,000
Fixed asset (Net)	80,000	Contributions	12,000
Intangible assets	0	Earning, excluding compensation to officers	22,000
Other assets	16,000	Plus compensation to officers	30,800
Total Assets	220,000	Earnings before taxes, including compensation to officer	52,800

Your earning on assets would work out to be 220000 ÷ 22000 = 10%

If the networth of the firm is given as Rs. 78,000 then the return on networth (before taxes) would be 10,000 ÷ 78,000 = 12.8%.

You can now compare these figures to those of similar firms, or with the data on earnings of SSI units available with your local small industries service institute (SISI) or the local D.I.C. The data is normally given industrywise. You can therefore compare your figures with the industry norm.

The Total Performance Index

You can develop a total performance measure by combining the sales index with the financial performance measure. This index also give a basis for some preliminary diagnosis.

In order to do moderately will a business should be able to as well as the average performance level (indicated in Table 1) as also on the front of earning on assets (in which case average performance can be assumed to be 1 to 1 i.e. 100%). The total performance index would then be 1.00×1.00=100%. The total performance index of a business is the product of its sales and earning indices. This is how you can calculate your own total performance index.

Take your own sales performance figure and divide it by the third line from Table 1 under average performance for the relevant period.

If we take the same assumption that we took under average performance then your own sales, should be increasing by 4% through addition of new customer and you should be experiencing a 60% repeat customer rate. Suppose you are in your second year of business and in your case the total customer purchases are 150% of the first year. In the Table A the number of customers in the 2nd year under average performance has increased 164% over the first year. Your sales performance index then would be 150%÷164%=91%.

2) Calculate your earning on assets and divide them by the industry norm for your type of business. Suppose your assets are Rs.220,000 and your earnings before taxes are Rs.68,000. The earning on assets would be 31%. If the industry norm for your type of business is 27% then your index of earning performance would work out to be 31%÷27%=115%.
3) Now find out the product of the sales performance index and the earning performance index (91% × 115%) you get a total performance index of 105%.

The diagnosis of this figure would be that you are displaying slightly above average performance (the total performance index for average performance is 100%) with a better financial performance on earnings but below average marketing performance. The suggested remedial action obviously would be to strengthen your marketing effort.

Table 2 suggests some other possible combinations of total performance index with diagnosis which may suggest appropriate action.

Table 2

	Total performance index	Sales performance index	Earning performance index	Diagnosis
1)	121	110	110	Excellent overall performance
2)	110	110	100	Good sales average earnings
3)	110	100	110	Good earnings, average sales
4)	100	100	100	Average Performance
5)	90	90	100	Poor sales, average earnings
6)	90	100	90	Poor earnings average
7)	81	90	90	Poor earning poor sales

The case 1 shows outstanding performance cases 2, 3 could improve on the areas (Sales or earning) where they have average showings but they are still above average. The problem cases are 5, 6 and 7 where case 5 needs to pay special attention to augment the sales and marketing efforts and case 6 needs to work hard on his financial management to improve his prospects on earning performance index. Case 7 is the one with real problems that may threaten his survival. He would need to improve both market growth and return on assets if he is to survive.

You have already seen that the sales performance index is actually made up of two factors i.e. the new customers and the repeat customers. In all cases where the marketing performance is low, you would have to analyse whether it is due to low percentage of repeat customers or deficient addition of new customers.

The overall performance index enables you to evaluate your overall managerial performance against other entrepreneurs and give possible clues to the causes of your problems. The following sections will give you more information to enable you to follow up on the diagnosis given by the total performance index.

Activity 1

A) Collect the relevent figures from your balance sheet and income statement (or those belonging to any small scale enterprise that you are familiar with) and try to work out
(a) your sales performance (b) your earnings on assets

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B) Taking Table A and the average performance figures and assuming you are in your fifth year of operation work out your sales performance index.

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C) Assuming that the industry figure for earning on assets in this type of business is .25, work out your earnings performance index.

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D) After calculating your total performance index, what is your diagnosis for your firm/the firm you have taken into consideration.

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14.3 SHORT TERM MEASURES: CONTROL OF CASH FLOW

Cash crisis is a very frequent ailment afflicting small enterprises. Often enough developing as unhealthy outcome of rapid sales growth which has not been accompanied by generation of cash to pay the bills! While enlarging business in the growth phase i.e. getting into the heady experience of being able to add new customers fast and retaining old ones, the entrepreneur often focusses so strongly on building up sales and earnings that he may start generating expenses for expanding the business faster than he can collect cash from customer. The cash flow statement provides a way of relating your sales and earning efforts with their effect on the cash balances.

The purpose of the cash flow statement, as you have already seen in Unit 10, is to trace impact of operations shown in the income statement, upon the cash accounts with the objective of enabling you to maintain enough liquidity to pay your bills in time.

In order to act as an evaluation and control tool the cash flow statement has to be projected into the future. You need a reliable estimate of your cash needs in future in order to avoid a cash crisis or worse, an insolvency on your hands. The possible remedial action in case of cash flow being deficient in meeting cash needs would be

- you can reduce the volume of business and therefore your expenses to reduce demands on cash
- you can expedite collection on accounts receivables
- borrow additional funds from the bank or
- put in more cash yourself if you can.

In order to estimate your cash needs in future you can draw a cash flow schedule and use it as a measure of control as well as evaluation. A cash flow schedule is the projected estimate of cash receipts and expenditures which enables us, if it is followed, to pay our bills in time. In order to make a cash flow schedule you would have to

a) Estimate your cash sales per month.
b) Estimate your sales on credit, the accounts receivables and the customer payments per month by aging the accounts receivable.
c) If you have any other cash receipts like those accruing from a loan collection or sales of assets, estimate them also.
d) A total of (a+b+c) gives you the total of cash inflow per month.
e) You can now estimate your cash outflow by first estimating the payments you expect to make per month.
f) Estimate the payments you expect to make for your purchases.
g) Estimate amounts to be paid on account of salaries.
h) Calculate monthly operating expenses like rent, repairs, supplier and so on.
i) Add (f+g+h) to get the total of your cash outflows.
j) Substract the cash outflow from the cash inflow to get cash balance at the end of each month.

This projected cash flow schedule in order to function as a tool of evaluation, should be compared by what you actually experience, month by month, in term of cash flow. Any shortfall in cash receipts, additions in outflow on unutilized cash balance in excess of your needs must be investigated.

How much cash do you actually need at hand? Ideally, while you would like to have enough to enable you to pay bills in time, as you would not want to have so much cash around that it lies idle and does not earn a profit for you. Two ratios have been used to give an idea of the type of liquidity a business should maintain.

The current ratio is a ratio of all current assets (including inventory) to all current liabilities. Conservatively, this ratio should be 2:1. You can, on the basis of what you actually experience, annually, work out your current ratio to find out if you have liquidity in excess of your needs or vice versa.

Acid test ratio is a ratio of cash plus receivable to current liabilities. The ratio should at least be 1:1 in order to meet the acid test of paying all your current creditors.

Activity 2

Talk to at least three entrepreneurs, find out how they estimate their cash needs and plan their cash schedules. In case they work out their current and acid test ratios what is the norm they follow, in maintaining cash balances?

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14.4 MEASURES OF MARKETING PERFORMANCE

You have already studied in Unit 12 how a marketing plan should be drawn up. As a performance appraisal measure then, you would like to have some indicators which could tell you whether your sales targets would be realised as per the plan or not.

You would recall from the marketing plan that you had set targets for marketing tasks and budgeted the marketing performance. The most general form of control then would be to monitor the actual performance and to compare it with the budgeted performance on all targets, periodically. The variance in terms of sales targets, market coverage and distribution costs can be analysed to find out the underlying reasons. Corrective action could then be taken either towards improving performance or modifying the targets to make them more realistic. The tools used to check on plan performance are many. Of relevance to us here are sales analysis, market share analysis, sales expense and financial analysis.

Sales analysis comprises of measuring and assessing actual sales against sales targets. The two specific tools that are used are sales variance analysis and micro analysis.

Sales variance analysis finds out the role each contributing factor has played in causing the variation between planned and actual performance. If the planned target was achieving a sales figure of 80,000 by selling the product A at Rs. 2 per unit (or selling 40,000 units) and the actual sales were Rs. 48,000 as only 30,000 units could be sold at Rs. 1.60, your sales performance variance is Rs. 32,000 or 40% of targetted performance. Sales variance analysis would let you understand what part of this variance is attributable to poor sales target achievement and how much can be attributed to the price cut. You can calculate it as shown below

Variance due to price variation	= (2–1.60)×30,000
	= Rs. 12,000 = 37.5%
Variance due to shortfall in sales target	= (40,000–3,0000)×2
	= Rs. 20,000 = 62.5%
	32,000

Your calculations show that almost two-thirds of your variance is due to decline in the sales volume. You must closely examine the reasons why the targetted volume was not achieved.

You may find the answer by carrying out a **micro sales analysis**. Micro sales analysis consists in analysing your sales performance productwise, territorywise, sales personwise by comparing the actual performance with target or sales quota. Quotas are quantitative target assigned to territories and salespersons individually, which then also function as standards against which the territory performance or salesperson performance can be measured. In the case discussed above let us assume that the company was selling its product in three territories A, B, C, the targetted and actual performance was as under

Sales in Units

	Territory A	Territory B	Territory C	Total
Targetted Performance	15,000	5,000	20,000	40,000
Actual Performance	14,000	5,250	10,750	30,000
Variance	– 1,000	+ 250	9,250	– 10,000

The micro sales analysis clearly reveals that while territory A shows a small negative variation, territory B shows a surplus and territory C displays a 46% deficit against the targetted performance. The indicated managerial action is to analyse territory C thoroughly and unearth reasons for the poor performance.

Market Share Analysis — While sales analysis measures your performance in absolute terms, market share analysis gives you an idea of your performance relative to your competitors. As an entrepreneur competing in the market you need to monitor the share of the market you have been able to capture, simply put — an increase in your market share means you are gaining on your competitors, a decline shows you are losing out to them.

Several measures of market shares are in use. Relevant to us are

- Overall market share — a firms overall market share is the sales of the firm calculated as a percentage of the overall industry sales. If you are a manufacturer of TV picture tubes, your sales figure expressed as a percentage of the sales of the whole picture tube industry would give you your overall market share.
- Served Market Share — The market, out of the overall industry which is served by the company offering is known as the served market. The served market share therefore is the company sales expressed as a percentage of the total industry sales in the served market. To develop the example given above, if you were making picture tubes for the colour TV only, your sales expressed as a percentage of the sales of colour TV picture tube industry would give you your served market share.

You can decide upon which particular we assure you would like to use. While industry sales data for overall market share are for more accessible as secondary data, served market share in a more relevant measure for small industries. You may have to take estimates of your served market periodically to get an idea about the overall served market sales figure.

How do you use the market share information? Suppose your market share (in rupees) fell during 1991. Following may be the possible reason

- you have lost some of your old customers to competitors.
- your competitors added on more new customers than you did.
- your existing customers are not buying as much of their supplies from you.
- your present customers are smaller buyers as compared to your earlier ones whom you lost.
- your prices have become lower relative to your competitors.

By regularly monitoring the above factors over time, you can diagnose the reasons for dip in the market share.

Control of Selling Expenses — Another form of marketing control, the periodicity of which can be determined according to your own needs, is to appraise your sales expenses against others. Depending upon how much personal selling is being used, selling expenses vary by type of product and industry. Total selling costs (including salaries of sales personnel, sales management costs travel and promotional expenses) usually vary in the range of 7 to 15% of sales. The lower percentages apply to standardised products of established performance. In products where the quality and performance is to be demonstrated or personally explained, sales costs tend to be higher. You can use two approaches here. You can compare your sales expenses with the targets that you have set for yourself as part of the marketing budget, or utilizing the statistics available from the local S.I.S.I (small industries service institute) you can compare your sales expenses to your specific industry type to find out how are you faring in respect of these cost.

If you are comparing your sales expenses against set targets, you may actually disegregate the sales expenses into various sales expense to sales ratios. You understand that your sales expenses comprise of sales force expenses, advertising expenses, sales promotion expenses and sales administration expenses. While setting targets you may express target for these expense components as percentage of sales, which then act as norms against which actual expenses can be measured. On a monthly or quarterly basis you can then monitor all these expenses through a control chart which shows acceptable and unacceptable ranges of variation between targetted expense ratio and actual expense ratios. Deviation falling in the unacceptable ranges may then be investigated to unearth reasons for these variations.

Qualitative Measures of Marketing Performance — All the measures discussed in the context of marketing performance so far are quantitative in native. Qualitative measures, which allow you to have an idea of consumer attitudes towards your product and services, enable you to be proactive and responsive to the needs and preferences of your consumers. One common tool that is often utilized is analysis of consumer complaints and suggestions. These complaints when analysed may provide a pointer to the trouble spots in your marketing offering. Similarly complaints in response to changes/modifications in the total product offering may lead you to a reassessment of the modification decision.

Periodic surveys of consumer attitudes regarding your products and services also furnish valuable information in respect of consumer expectations and evaluation of your offering. The findings may enable you to plan better or improve performance in spheres which have been sources of consumer dissatisfaction.

Activity 3

A) Contact three entrepreneurs, such that you have one industrial product manufacturer, one consumer product manufacturer and one service manufacturer. Discuss with them to find out the tools of marketing control that they are using.

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B) Could you suggest in each case some additional/alternative measures of performance assessment and control, which you think would serve these entrepreneurs better.

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14.5 PRODUCTION SCHEDULE AS A EVALUATION AND CONTROL TOOL

While going through Unit 11 on operational management issues in S.S.I. you studied the formation of a Gantt Chart as well as the simple network charts. All of them form part of setting up the production schedule, which simply put, is the organisation of production operations in a given time frame.

A production schedule when formed, is the single most effective performance measurement for your production operations. It is better than a comparison with other firms, because it is designed to reflect your own work situations.

Once the production schedules are established, control can be exercised by monitoring actual performance to see that it is on time as expected by the schedule. Any unacceptable range of variation is reported through exception reporting to take a note of the components of the operation which are not functioning well in time. Analysis can then follow to pinpoint reasons for variance from expected schedule.

Inventory Control — Inventories form a major share of investment in most businesses, ranging from 30 to 40% of total assets in retail and wholesale trade and from 15-25% in manufacturing organisations. The very size of the investment makes it an important variable from the control perspective. What makes it an interesting excercise in control in the fact that typically the highest usage item may constitute only 10% of the items in stock but account for 70% of the usage, some 20% of the items may account for 20% of the usage and the remaining 70% may account for only 10% of the usage. This has important implications for inventory planning and specifically in deciding how much money should be tied up in particular categories of inventory. Inventory control should therefore assure that (a) the active inventory items are always in stock so that there are no lost sales because of a stockout condition and (b) that the inactive items are carried at an essential minimum so that they do not tie up money and space.

Control of inventory comprises of two essential activities. The first consists in maintaining records to indicate clearly the major items in inventory on access cards or stock cards as they are commonly called. The second activity consists of setting up procedures for timely reordering of depleting inventory.

The stock cards are utilized to indicate the amount of inventory of a particular item on hand, the withdrawl of stocks in quantities datewise, the average usage rate and the reserve in stock at the point of reordering.

The periodic reordering on the other hand involves two decisions — the reordering time (called the reorder point) and the quantity of reorder. The reorder point is calculated by multiplying the usage rate per day with the lead time in days, required for the delivery of order. Suppose you are using iron ingots as raw material, the usage rate of which is 300 kg. per day. The lead time to get the order delivered is 5 days. Your reorder point is 1500 kg. Every time your stock card shows a withdrawl to the level of 1500 kg of ingots you would reorder. This situation assumes that there would be no failure on the delivery time schedule, which may not be always true. To provide for such contingencies, specially in critical inventory items, there is a practice of carrying safety stocks, a fixed quantity of inventory over and above the reorder point.

The quantity to order is generally governed by the economic order quantity, calculated by using the holding costs and the ordering costs of the inventory in question. The holding cost comprises of costs involved in holding or carrying the inventory i.e. interest on capital tied up in inventory, insurance and handling costs, cost of storage space and cost of losses and pilferage. The ordering costs are the administrative costs of placing and procuring orders for the inventory. The EOQ is calculated as

$EOQ = 2\,OD \div C \times I$

where D = average annual demand
O = ordering cost
C = cost per unit of the ordered item
I = percentage inventory carrying cost

To summarise, inventory control is the excercise of anticipating buying needs from demand and usage and then buying in economic lot sizes to minimise holding and ordering costs.

Activity 4

Select a small scale entrepreneur running a restaurant. Design an inventory control process for him. Also try to set up a production schedule for his "evening meals production operation."

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14.6 ASSET MEASURES OF PERFORMANCE: SOME FINANCIAL RATIOS

One of the objectives of running a business is to make the assets and the networth of the business grow over years. In section 14.2 of this unit you read about the earning on asset measure of performance. Besides this overall general measure, some financial ratios are commonly used by entrepreneurs to assess their own performance. Some of the prevalent measures are:

Sales to Receivables Ratio — Also known as receivables turnover, this ratio tells you how expeditiously you get your receivables paid by your customers. The norm varies from industry to industry ranging from 33 to 80 times a year for the pharmaceuticals and drugs business showing the rapid repayment rates in this business. A lower than industry norm suggests that your collection procedures need tightening up as your accounts receivables are taking longer than the norm to get converted to cash.

Cost of Sales to Inventory Ratio (Inventory turnover) — The ratio is indicative of the efficiency with which the inventory gets converted into sales. Median ratios for industry as a whole are available which show considerable variation across industries. A lower than industry norm tells you that you have more capital tied up in inventory and are earning lower profits because of lower sales.

Sales to Working Capital Ratio — This ratio tells you how efficiently you are using your working capital. If in a given business the median ratio is 9 times, it means that the sales are about 9 times the working capital which shows that the working capital on an average is being recycled every 45 days. A high sales to working capital ratio is indicative of high earnings while a lower than the norm for your kind of business is indicative of the fact that you are bearing a higher cost of capital.

Earning Before Interest and Taxes to Interest — This ratio is obtained by dividing the EBIT by the interest charges payable by the firm. This ratio is primarily used by bankers and creditors to assess how protected their loan is, because the ratio indicates how many times their interest charges are earned.

Creditors usually prefer a ratio of 3:1 so as to ensure that their interest charges shall be secure even in the event of unfavourable fluctuations in earnings.

Fixed Assets to Tangible Net Worth Ratio — This ratio obtained by dividing the net fixed assets by tangible networth, is indicative of the extent to which the owners equity has been invested in plant and equipment. A lower ratio would mean a smaller investment in fixed asset as compared to networth, and would therefore be favoured by creditors.

Total Liabilities to Networth Ratio — This ratio of total debt to tangible networth shows the extent to which the owner, compared to the creditors has contributed to the capitalization of the firm. The higher the ratio, the greater would be the risk to the creditor as his contribution relative to the owner is higher in capital formation. A lower ratio indicates that the owner is providing bulk of the capital and the creditor therefore is relatively secure.

Sales to Net Fixed Assets Ratio — This ratio is obtained by dividing the sales of the firm by the net fixed assets. It is indicative of the extent of utilization of productive assets by the business. A very high ratio shows that the business is highly labour intensive and the fixed assets are not much used or are highly depreciated.

Older firms with depreciated fixed assets would therefore have higher ratios than comparable newer firms. If you are using this ratio for comparison purposes careful attention must be paid to the age of the firm and the depreciation already allowed by you.

14.7 A COMPREHENSIVE CHECK LIST TO RATE YOURSELF

Having gone through the different aspects of your business that you may need to assess your performance in, you may now be in a position to give yourself an overall rating for your business. An overall performance assessment, however requires far more variables to be included than what we have just been discussing. Given below is an illustrative check list (you can draw up additional items to put into as per your specific requirements) which can be used to arrive at a comprehensive picture of your own enterprise. Such an listing may help you identify probable areas of weakness and highlight activities/procedures worthy of attention.

Area	**Attention accorded by you**			
	High	Medium	Low	Nil
General Management				
1) Existence of business strategy and business plan.				
2) Clear definition and communication of organisational goals.				
3) Participation of operating personnel in annual budget.				
4) Regular monitoring of expenditures, sales, profit against targets set.				
5) Assignment of responsibilities for specific goal/objective attainment.				
6) Clearly defined organisational relationships				

Personnel	**Attention accorded by you**			
	High	Medium	Low	Nil
7) Policy and procedures clearly communicated to the employees.				
8) Compensation plans clearly defined and periodically reviewed.				
9) Updated job description for all jobs.				
10) Performance evaluation job discussed with employees.				
Financial Position				
11) Current financial statements.				
12) Current profit and its analysis.				
13) Cash flow projection both short term and long term.				
14) Comparison of financial ratios with other, similar competitors.				
Marketing				
5) New market and product development plans.				
6) Formal assessment of market and product performances.				
7) Sales analysis and contribution analysis by product, time, customer accounts, markets territory, sales people.				
8) Long and short term sales projection.				
9) Periodic evaluation of promotional plans.				
Production				
0) Reliability of supply sources.				
1) Development of standard costs for each significant operation.				
2) Periodic monitoring of monthly production schedules.				
3) Production tasks clearly defined and assigned.				

24) Time and cost sheets assigning material and labour costs to products and cost centres.
25) Plant and labour productivity review.

Purchasing

26) Purchasing assignments and authority clearly defined.
27) Order cycle for purchase requisitions for both short term and long term requirements reviewed.
28) Development and review of consolidated purchasing plans by commodity and by suppliers.
29) Systematic inventory system synchronised with purchasing action in repetitively purchased products.

Rate each of the above management requirements according to the degree of attention you give them in the organisation. This check list serves like a illustrative management audit. You can add to the list to include your specific requirement.

14.8 SUMMARY

A small scale entrepreneur needs to have a far more continual performance appraisal and control of his operations, both financial and marketing as he has very few reserve resources to fall back upon. This unit discusses overall measures of performance evaluation and control as well as function specific measures. Both quantitative and qualitative measures of control have been discussed. Frequently used financial ratios have also been described. The unit also provides a comprehensive check list to enable the small scale entrepreneur to carry out a diagnostic audit of his own enterprise.

14.9 SELF-ASSESSMENT QUESTIONS

1) Comment upon the need for performance evaluation and control for a small scale entrepreneur.
2) What are the measures of overall peformance that can be used to assess the working of an S.S.I unit? Explain with an example.
3) How does the production schedule operate as a control tool? Explain.
4) What measures of performance assessment and marketing control would you apply for the following S.S.I enterprises?
   (a) A beauty saloon
   (b) A boutique specialising in exclusive apparel.
   (c) A bakery specialising in supplies to the mid-day meal schemes of some public schools.

14.10 FURTHER READINGS

Stahrl W. Edmunds' *"Performanced Measures for Growing Business"*, Van Nostrand Reinhold Company, New York, 1982.
E.F. Schumacher, *"Small is Beautiful"*, Harper and Row, New York, 1973.

UNIT 15 STRATEGIES FOR STABILISATION AND GROWTH

After going through this unit you should be able to:
- describe the various stages of growth in the life of a small scale enterprise
- explain the managerial implication of these stages
- discuss the strategies used for stabilisation
- enumerate the characteristics of growth business
- discuss and apply growth strategies for small enterprises.

Structure

15.1 INTRODUCTION

In earlier Units we discussed the processes involved in the setting up of a commercially viable and technically feasible small scale enterprise (SSE). We also examined the various implications for functional areas such as finance and marketing in a SSE context. In this Unit, we will take a holistic view of SSE management at the stabilisation and growth stages of an enterprise. We will identify some of the successful strategies which might help a SSE pass through these two stages successfully.

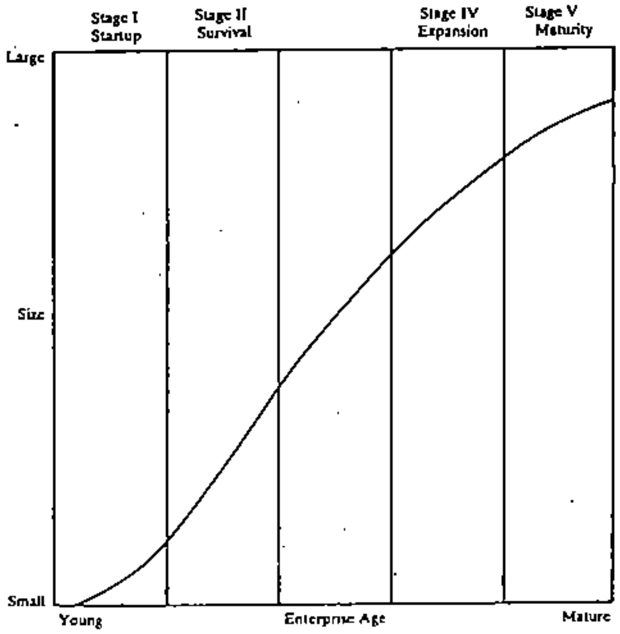
15.2 STAGES OF GROWTH

We have studied that all products pass through different stages in their lives; this is called Product Life Cycle. Similarly, new and small enterprises pass through distinct stages (each with its own characteristics) as they develop and grow. The strategies required to effectively cope with each stage also vary. This calls for an understanding of what could be expected at each stage to enable entrepreneurs prepare themselves to avoid crises due to adjustment problems. Very often sickness in SSE is due to lack of such preparedness.

The stages in the life of a new firm can be broadly classified into five: start up, survival, growth, expansion and maturity. As shown in Diagram 1, the enterprise, grows in size as it moves forward on the firm life cycle; firms grow older at the same time. It should be noted that size of the enterprise can be measured in different ways such as sales, assets and number of employees. It should, however, not be construed that a finite level of activity measured in any one of these ways automatically takes any enterprise from one level to the other. The time taken for any firm to move from one stage to another varies widely. Also, not all enterprises survive to grow large. This may be due either to the nature of the activity or simply to the personal desires or ambitions of the entrepreneur.

Diagram 1

ENTERPRISE GROWTH STAGES



The characteristic changes that take place at different stages can be seen from the following illustrations.

	Start up	Survival	Growth	Expansion	Maturity
Entrepreneur Role	Direct Supervision	Supervised Supervision	Delegation Coordination	Decentralisation	Decentralisation
Management Style	Entrepreneurial, individualistic	Entrepreneurial, administrative	Entrepreneurial, coordination	Professional, administrative	Watchdog
Organisation Structure	Unstructured	Simple, centralised	Functional, partly centralised	Functional decentralised	Decentralised functional/ product
Product and market	None	Little	Some new product development	New product innovation, market research	Production innovation

We notice here the metamorphoses taking place in an organisation at every stage. It is in this background that we look at the critical problems faced at each stage by an entrepreneur and the broad strategies required. For the purpose of our discussion here, we club start up and survival strategies together as stabilisation strategies and growth and expansion strategies as growth strategies.

Activity I

Collect data on a sample of five small scale enterprises such that you have one enterprise belonging to each growth stage described above. Do the characteristics displayed by your sample, in terms of management style, organisational structure, product and market, match these shown in the texts. Describe the characteristics shown by your sample, if they differ from the text.

Variables	Start up	Survival	Growth	Expansion	Maturity
Management	....	....	....	....	....
Style	....	....	....	....	....
Organisational	....	....	....	....	....
Structure	....	....	....	....	....
Product	....	....	....	....	....
and					
Market	....	....	....	....	....

15.3 STABILISATION STRATEGIES

This and subsequent stages of an organisation are different from the stage where an entrepreneur identified an opportunity and set up an enterprise. Now an entrepreneur graduates to become a manager. He has to undertake the functions of a manager such as planning, organising, coordinating and control. Several enterprises fall sick partly because they do not get adjusted to the new responsibility of a manager.

This is essentially the stage when a new enterprise gets settled down and stabilises its activities. This is where we find entrepreneurs start getting orders regularly and supply stabilises. The firm's sales crosses the break even point for the first time at this phase. Also in the light of increased capacity utilisation the firm gets more inflow of cash than outflow.

Stabilisation phase can be treated as one of the most critical periods in the life of any enterprise. This is especially so in the case of SSE mainly because the entrepreneur has to run a one-man show taking care of most of the operations. He will have to spend enormous amount of time on the new enterprise. It is like taking care of a new born baby until it can manage its affairs on its own. The entrepreneur has not only to have a long-term vision and strategy for the organisation, but also have adequate knowledge to solve problems arising in areas such as finance, marketing, production and personnel.

In short, the major challenge will be in terms of manufacturing a product or providing a service which will be commercially acceptable in terms of price and quality and establishing a place for it in the market place. This is the process of creating an identity for the firm in the commercial society. In most cases, entrepreneurs start with a single product or service. In the following paragraphs we shall see some of the critical areas of concern at this phase and the possible strategies to overcome them.

Cost and Time Overruns

Very often entrepreneurs believe that what has been planned in the project report would come true, and there would be no time and cost overruns. In reality, all assumptions made regarding completion of procedures, availability of finance, input and market conditions do not hold good when the firm starts commercial operation. To elaborate, if an entrepreneur has already spent all funds available on creation of fixed assets, resulting in cost overruns, there will be hardly anything left for working capital margin money. As a result, the firm will not be able to maintain the level of operation projected earlier affecting its profitability badly. Under such circumstances, the entrepreneur will have to review his plans for working capital management. If more funds are invested in fixed assets than anticipated, the break even level of operation of the firm would go up, again affecting its profitability. Also, because of time overruns, if competitive position of a new enterprise is threatend by environmental changes, the entrepreneur may have to review both input and output strategies to be competitive.

This calls for reassessment of the project, not only its external environmental opportunities and threats, but also internal strengths and weaknesses. The enterprise strategy has to be reformulated in the light of such an exercise; accordingly, functional strategies also will need revision. New small entrepreneurs are best advised to make realistic or rather conservative estimates and keep enough liquidity to cope with changed situations.

Building Strengths

All enterprises require certain strengths, but they vary from firm to firm depending on the size, nature and level of competition. Most entrepreneurs may not initially possess multifaceted skills required to adequately attend to all the functional areas. Deficiencies in any area would naturally affect operations of an enterprise to small or large extent depending on the criticality of the function. For instance, several technically qualified entrepreneurs who can produce high quality products miserably fail for lack of marketing skills or for improper costing and pricing. Cost conscious financial experts, on the other hand, often fail to produce good quality products acceptable to customers.

Despite their limitations, many entrepreneurs successfully tackle stabilisation problems. They are aware of their strengths and weaknesses and the criticality of each function. They handle functions where they are confident of their strengths, but try to acquire additional strengths wherever and whenever required. Some entrepreneurs possessing expertise in production ask other organisations to carry out the marketing tasks for them. They may either continue this arrangement or start marketing on their own after some time once they have acquired enough expertise.

It is clear from the above discussion that entrepreneurs should be realistic about their strengths and weaknesses. If they do not possess some critical strengths, they should either build them or recruit/associate with others to have the benefit of their specific strengths. It will be suicidal to venture into entrepreneurial activities without recognising the strengths required to exploit opportunities and thwart threats, and the willingness to build strengths whenever required.

Coping with Competition

In the conventional sense competition is considered only in the marketing context. Porter (1980) has, however, shown that this is a limited vision. In fact, an entrepreneur faces competition from four sources: existing firms in the same line of activity, suppliers of inputs, buyers of product or service, and possible substitutes. It is the bargaining power a firm has against each of these constituents which determines its competitive position. For instance, while projecting the market demand, very often entrepreneurs do not anticipate the ways in which firms in the same activity would react. If the market size is vast and the new entrant is insignificant in terms of size of operation, retaliation from competitors will be minor. There are, however, situations where a next door neighbouring shop might retaliate badly for sheer survival.

Suppliers of materials, labour and infrastructure also might change their strategies based on the changed situation emerging from the entrance of a new entrepreneur. Similar might be the effect on buyers and possible substitutes. The basic rule to follow in such circumstances is to "Know thy competitors well, their strengths, weaknesses and strategies".

Recruitment and Retention of Personnel

One of the major problems faced by new enterprises is identification, recruitment and retention of the right kind of personnel. A new enterprise is generally weak in terms of an established name and ability to offer very attractive terms of employment. Above all, an entrepreneur should recruit the right kind of people who could contribute to the success of the organisation. Their attitude to work, temperament etc. are important considerations for a good entrepreneur. These conditions are not likely to motivate good quality people to join such a new enterprise. They would be concerned about factors such as lower than average remuneration and other terms, risk of losing job, and lack of job satisfaction.

An entrepreneur should be clear about his personnel policy from the very beginning. Several entrepreneurs use their social contacts to recruit people. Some of them explain to their employees the enterprise mission and strategies. They might offer part ownership in enterprises or have some profit sharing schemes. The enterprise strategy towards personnel should be formulated based on these realities.

Avoid Overtrading

In their eagerness to grow fast, some entrepreneurs tend to undertake more work than what they could really do with the available resources, leading to overtrading. Such instances might result in imbalances in the system such as building up of inventories or receivables without leaving enough cash to carry on operations. This results in effective reduction in working capital and could lead to industrial sickness unless rectified in time. Entrepreneurs have to remember that they should bite only what they could chew.

Developing Systems

Closely linked to strategy is the control systems in any enterprise. Although, no formal systems could be noticed in a new enterprise at this phase, the entrepreneur should start working on the development of systems of control. It is when systems get established that entrepreneur finds more time for developing new strategies.

In short, stabilisation strategies are critically important for the very survival of the enterprise. It is entrepreneurs who can keep on expanding activities in the beginning according to organisational capabilities, are the ones who can cross the stabilisation phase successfully. Several entrepreneurs remain in this phase for lack of any clear strategy. We have to remember that a new enterprise is like a new baby; it needs attention, tender care, but no overfeeding. Similarly, a new baby should not be forced to walk or run before it learns to crawl and sit.

As an enterprise gets stabilised, it has to start thinking in terms of its growth, unless, of course, the entrepreneur consciously decides not to grow. In the rest of this unit we shall see what growth strategies are and how such strategies help firms achieve fast growth. Discussion related to stabilisation strategies such as overtrading will continue to be relevant even in this stage.

Activity 2

a) Talk to at least 3 entrepreneurs who have recently set up their small enterprises. What were their problems in the phase of stabilisation? What were the copying strategies they used to get over these problems?

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b) Can you suggest some suitable alternatives to these entrepreneurs (looking to their specific problems) for their stabilisation related problems.

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15.4 GROWTH STRATEGIES

These strategies are formulated and implemented by firms which want to grow. Such firms have to maintain sustainable competitive advantage by delivering superior value to the customer. Although it is difficult for any firm to be an ideal growth business, it is worth attempting to reach that ideal. Some of the important characteristics of an ideal growth business are given below (adapted from Hann, 1987).

a) A near monopoly that can dominate a market because of patents.
b) A business where the rate of growth in profits is far higher than the rate of growth in sales.
c) A business which can grow relatively independently of economic cycle.
d) A business that has a consistently high rate of inquiries and new and repeated orders.
e) A business that is dependent on management talent.

It becomes apparent from the above that only firms providing unique products or services which are highly valued by customers can grow fast. A fast growth entrepreneur would shape his strategy depending on the situation. For instance, manufacturers of detergents such as Nirma and Surf follow entirely different strategies. So is the case with match box manufacturers such as Wimco, a multinational on the one hand and small scale competitors on the other. Manimala (forthcoming) observed after a study of 186 decision heuristics (rules) that most of them are context specific. Nobody should try to copy any heuristic blindly. Some of the important strategies which can achieve this are discussed here.

Value for Money

Growth firms provide value for money to their customers. They provide so much value to the customers compared to the cost involved that the customers are promoted to buy the product or service repeatedly and/or in larger quantities. For instance, a new bakery operator started and grew very fast to become the largest confectioner in the city mainly because he always provided very high quality products to customers. They always wanted such products and were willing to pay a little more for better quality products. This new entrepreneur was the first to notice this as an opportunity and exploit it. What he did was to give value for money to his customers. It is not the absolute amount or money, but the value in relation to the price they pay that matters. This is applicable both to manufacturing and service sectors. In India, a significant number of the urban customers are not happy with many of the things they buy or the service they get. They are willing to pay a little more, if the product or service is worth it. Growth entrepreneurs keep exploiting such opportunities.

Grow Your Customers

Growth of an entrepreneur depends on the satisfaction and growth of his customers. This is especially so in intermediate products or services. For instance, a small scale chemical industrialist developed a unique solvent to act as a drying agent in paint industry. He demonstrated to his paint manufacturing customer that by using his new solvent the paint quality would improve. The paint manufacturer used it and achieved better turnover. Similarly, a textile processing entrepreneur built up his customer base by giving useful suggestions to them on colour and shade combinations for fabrics.

In order to provide value for money and grow customers, an entrepreneur has to convince his customers with three things.

a) How much: The entrepreneur should be able to convince his customers with the quantity of incremental returns on his investments that is possible by buying the entrepreneur's product or service. In the case of consumer products, it is the incremental benefits or satisfaction which the consumer derives that matters.

b) How quickly: The entrepreneur should be able to tell the customer the speed with which he would be able to supply the product or provide service. In a competitive environment, speed is an important factor. This means that if the entrepreneur wants to help his customer grow, he should do it fast.

c) How definite: The customer should be given a definite idea about the entrepreneur's capabilities to help him grow. He will buy and continue to buy only if the promise stands the test of time.

One important observation we have to make on the above discussion is that we have not been talking about profits, but customer satisfaction. Although an entrepreneur has to make higher levels of profit, it should not be the bottom line to work towards. He has to think beyond, towards the customer without whom he cannot achieve growth and sustain it. This means providing growth values on a consistent basis. Also entrepreneurs should approach their customers and prove their growth values (such as the above) to build up business, to make a better impact. In other words, entrepreneurs should think of long term growth of the organisation and factors influencing it.

Maintaining Leadership

In a competitive environment, maintaining leadership is not easy. New substitutes and products made using new technologies would keep entering the market eroding competitiveness of existing firms. Under such circumstances, constant product improvement becomes essential to maintain product differentiation. Even in fields where competition is limited, it is worth attempting technological improvements either for cost reduction or product improvement. This means that the experience curve of such firms keep shifting continuously.

This is well reflected in the air cooler industry in the recent years. Although it is a seasonal industry, of late there is fierce competition to capture the top end of the expensive market segment. For instance, a leading national level manufacturer in the small scale sector entered the market with a revolutionary idea; an air cooler looking like a room air conditioner. It was technically far better than a conventional air cooler. He improved upon his new "air conditioner looking air cooler" and introduced three different models in three consecutive years, always improving upon the previous one, making it difficult for his competitors to catch up. Peter Drucker (1985) called it "fustest with the mostest" strategy. In the case of the solvent manufacturer referred to earlier also, there is a strong sense of product differentiation through technological development.

Developing a Niche Market

It is generally difficult for a small scale entrepreneur to be the leader in the national market in all the segments. Since customer requirements of the different segments vary, product/service features also will have to vary. Under such circumstances, most growth firms tend to specialise in a segment of the market, finding a niche for the produce/service. Such specialisation enables new firms to acquire and use their strengths to effectively face competition from large enterprises operating across the spectrum.

Niche market may be based on geographical classification of target segment. Nirma washing powder became a success mainly by specialising in the lower end of the market where utility is the most important consideration of the customer. Nirma identified that detergents such as Surf were too sophisticated for rough clothes such as bed sheets and dailyware garments, and the purpose would be served by a cheap, functional detergent. By pricing its products far below conventional detergents, Nirma carved out a niche for itself. Similarly, a fast growth ready-made shirts manufacturer in the small scale has been successful mainly because of his specialisation in executive shirts. In this niche market, customers look for mature, sober, fashion-free, functional and price sensitive shirts.

Flexibility

Entrepreneurs should be able to change their strategies according to environmental changes in order to register fast growth. As shown in diagram 2 (adapted from Mascarenhas, 1981) a firm would have low or high flexibility, and would operate in stable or unstable environments.

Diagram 2

Firm Flexibility and Environment

Environment	Low	High
Stable	(1) Inactive	(4) Proactive
Unstable	(2) Reactive	(3) Interactive

Firm Flexibility

We shall consider the four scenarios here.

a) **Inactive:** If the firm's flexibility to change either in terms of product, market or technology is low and if the environment is reasonably stable, the firm is likely to get stable returns. Except under monopoly or near monopoly conditions, firms cannot expect to make rapid growth in response to growing demand under such circumstances.

b) **Reactive:** Firms in the second quadrant also have limited flexibility, but have to operate in unstable environment: It is difficult for firms to plan and grow under such situations, and the entrepreneur will be forced to formulate strategies reacting to changes. It is advisable for entrepreneurs operating in such conditions to move out either by changing product mix or via market diversification. Although, it might involve additional investment, this option might be preferable to operating in such uncertain environments.

c) **Interactive:** In quadrant 3 environment stability is low. Since firm flexibility is high, several small scale activities can grow and flourish. For instance, fashion garment industry is very unstable, and only dynamic firms with a lot of flexibility can survive and grow there.

d) **Proactive:** Firms are most comfortable in quadrant 4 where they have the maximum flexibility to undertake any change in the environment or suo moto. The environment is stable here. Entrepreneurs can anticipate environmental changes clearly and formulate growth plans accordingly. Firms with strong R&D such as the solvent manufacturer can make product innovations for specialised markets and take advantage of premium pricing.

The above discussion shows the need to retain flexibility in enterprise activities from the very beginning. Success and growth of new enterprises depend on their ability to overcome their inherent weaknesses and to understand the environment and factors influencing it.

Quality-cost Link

Another strategy which is very successfully followed by several fast growth small scale enterprises is cost leadership. Nirma detergent powder and ready-made executive shirts cases mentioned earlier are examples of cost leadership in specific market segments. However, very often entrepreneurs tend to overengineer their products in the process of improving product quality. Developing high quality products is certainly a rewarding strategy under normal conditions, but will be counterproductive unless the market is ready to receive it. In other words, entrepreneurs have to find an optimum mix of quality and cost strategies.

Networking

Developing and maintaining contacts at social and formal levels is found to be extremely useful for business success. Fast growth firms do this consciously and systematically. For instance, an entrepreneur producing household plastic products (e.g. buckets) started building up contacts with dealers and users of pump-sets when he almost decided to diversify into PVC pipes. This helped him cut down lead time in developing distribution and sales arrangements. Similarly, a small scale pesticides manufacturer with long years of experience at the middle and senior levels in a multinational pesticides company could penetrate and start growing in the highly competitive pesticides market by making use of his extremely cordial contacts with industry.

Networking should emerge itself as a system to be very effective in the long run. The style and culture of the personnel would influence it. Networks can be built up for both operating and strategic purposes.

Entrepreneurs should remember that they cannot be opportunistic in developing and maintaining networks. It always has a 'quid pro quo' sense and therefore all the parties involved in a network should stand to benefit materially or emotionally.

Time

Earlier it was briefly mentioned that a fast growth entrepreneur should be able to respond to customer requests fast. In these days of increasing competition, entrepreneurs can build competitive advantage based on time, shorter the time, better it is. There are furniture makers, tailors and bakers who undertake production and delivery at very short lead time compared to competitors. 'One hour photo' laboratories and dry cleaning shop's also belong to this category. They in fact have identified a segment of the customers who are prepared to pay premium for quick service.

To be the first in the industry and reap the market as quickly as possible can grow an enterprise fast. Since creating a new industry or market involves great uncertainties one has to be careful while entering it. An entrepreneur who ventured into fresh cut vegetables activity in one city has found the going extremely good. Initially, he sold cut vegetables to restaurants and institutional canteens and later expanded to cover household market. He had the advantage of being the first to enter the market and build business first.

15.5 STRATEGY, STRUCTURE AND SYSTEMS

Strategies on their own will not make any firm fast growth oriented. Organisation structure and systems also play significant roles in turning a strategy successful. For instance, in a rigid, bureaucratic organisation where everything is done based on written orders, strategies sensitive to time will not work.

Control systems should also be tuned to implement the strategy. For instance, the success and growth of a restaurant operating in a highly competitive environment depends on the quality of items, lead time and attitude and behaviour towards customers, often more than on price. In such places, ordering and delivering systems have to be closely monitored to ensure competitiveness and resultant growth opportunities.

Control can be self-imposed also if the organisation culture is growth oriented, open and frank. Without a highly motivated workforce it is difficult to achieve high levels of growth. Developing a growth oriented culture is not an automatic process. The entrepreneur should have clear ideas about the enterprise mission, its strategy and the organisation structure and systems. He should find a match among them, and build a team of personnel to achieve the mission. The entrepreneur should learn to delegate as much as possible to his subordinates while retaining sufficient control. The various components of an enterprise should work like a well conducted orchestra to draw synergy and make it a growth firm.

Activity 3

With respect to the enterprises you studied for Activity 2 what growth strategies would you like to suggest for each of them?

Enterprise 1

Enterprise 2

Enterprise 3

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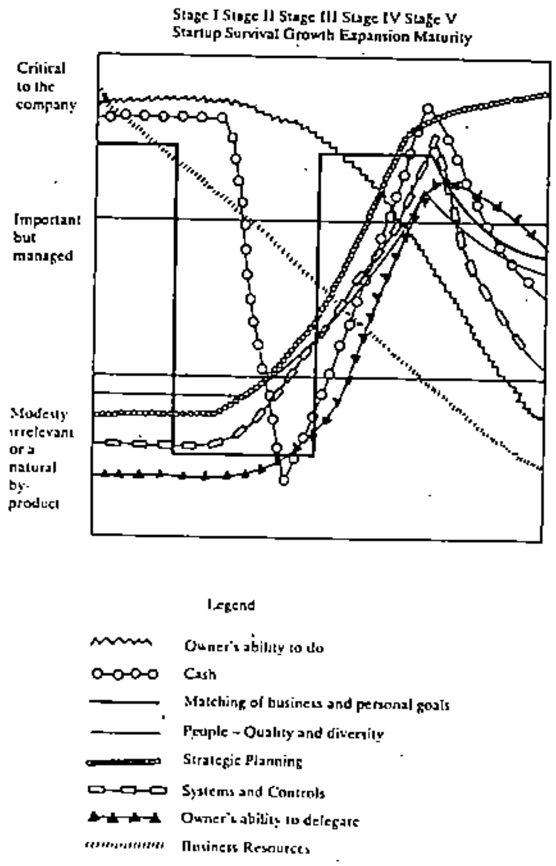
15.6 CHANGING MANAGEMENT DEMANDS

Since the internal and external requirements of an enterprise varies at different stages in the life of an organisation, it will be useful to examine the importance of some of the factors at the five stages.

Diagram 3

GROWTH STAGES AND MANAGERIAL CHALLENGES



As shown in Diagram 3, the managerial challenges change from stage to stage. Although the data related to a US study of 83 small scale enterprises, most of the findings have broad applications in the Indian context. An entrepreneur strategist must be able to visualise the changing scenarios and build strategies in advance for smooth transition from one stage to another.

15.7 SUMMARY

Discussion on the stabilisation and growth strategies have shown that dynamism is fundamental to rapid organisational success. Entrepreneurs should constantly look for new ideas and change themselves as and when required. The above strategies are not mutually exclusive. They are rather illustrative, and should be combined in appropriate ways to suit any given situation.

15.8 SELF-ASSESSMENT QUESTIONS

1) How do management challenges differ over the stages of growth in a small enterprise? Explain with the help of an example.
2) Discuss the opportunities and threats that free the entrepreneur in the stabilisation free.
3) Describe the various stabilisation strategies that can be used entrepreneur operating a fast food restaurant in a busy metropolitan market.
4) If you were a ready-made garment manufacturers about to enter the competitive field of exports of apparel, what growth strategies would you adopt to ensure a comfortable pace of growth.
5) Describe the organisational requirements for growth orientation in a small scale enterprise.

15.9 FURTHER READINGS

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UNIT 16 MANAGING FAMILY ENTERPRISES

Objectives

After going through the unit you should be able to:

- discuss the background to the development of family based enterprises in India
- highlight the dynamics of functioning of family based enterprises
- comment upon the typical strengths and weaknesses of family based enterprises
- discuss issues involved in the professionalisation of family business.

Structure

16.1 INTRODUCTION

An entrepreneur and a manager need to fully understand 'business', 'management', and 'entrepreneurship', in order to successfully step into today's business world. An understand of dynamism of these aspects would be incomplete if they are not studied in the context of family or a group of family running business enterprises.

Indian industry is largely dominated by family owned enterprises. They account for significant proportion in all spheres of socio-economic and political life of the country. Family owned enterprises have always been a matter of great curiosity as they are distinctively different from other forms of business enterprises (e.g. public sector, joint sector, cooperatives, etc.) in terms of their entrepreneurial, organisational and managerial behaviours and styles. This is because their behaviours and styles are subject to the forces arising out of emotions of family members, personal and interpersonal pressures of relatives of owners, and conflicting interests and values of family. The uniqueness on these aspects leads a business firm to exhibit a unique set of operational characteristics and face a unique set of issue and problems. This unit is devoted to the nature of family business enterprises and discusses issues and problems that are considered important in family owned enterprises.

16.2 FAMILY BUSINESS IN INDIA

Evolution

Historically, all capitalist economy became a birth place for family businesses. The right of possession of private property and its inheritance has been a major factor in encouraging the family business sector in India. The origin of family business firm coincides with the evolution of entrepreneurial firms. In the beginning, a few families were engaged in money-lending which led them to accumulate handsome capital. These families slowly moved into commercial activities and craft industries in order to profitably channelise their resource.

In the early nineteenth century, the industrial revolution called for speedy industrial development with greater emphasis on the modernisation of the production unit. This event came as major breakthrough for a large number of families. They promoted built and expanded all types of industries which the British Government of India encouraged. It is in this context that family businesses are considered the sine qua non of industrial development in the early days of industrialisation of the country.

The industrial enterprises were the result of joint family effort (capital) and therefore family control continued in the form of ownership and management. The family, therefore, became a unit of ownership, control and management of the firm. To exercise this, in the beginning they adopted the managing agency system which was started by British. The system was in line with the need of joint family and became a prominent feature of the Indian social structure. Several commercial and industrial enterprises were run by the managing agency system as a body of decision-making. The managing agency system continued till 1970 as an instrument of maintaining family control over business enterprises.

Monopolies Enquiry Commission[2], 75 largest business houses in India controlled 1536 companies accounting for 47% of assets and 44% of paid up capital of all non-governmental and non-banking companies. This indicates that family business has come to occupy a significant place in Indian industry.

16.3 FAMILY BUSINESS DEFINED

Various terms like 'family owned', 'family controlled' or 'family managed' are used to refer to family business. Terms like 'business houses' and 'industrial houses' are also used in the same context when a family is owning, controlling or managing a number of business enterprises. The central concern in using these different terms is the involvement of a family or a group of family in business enterprises in one way or the other.

Traditionally, a family business was defined as 'an enterprise in which a family or a group of families has invested a major share of capital'. This definition has not been found satisfactory as it did not clearly brought out the aspects like ownership, control and management of a firm.

Donnelley (1964) has defined family firm as 'one which has been closely identified with at least two generations of a family and when this link has had a mutual influence on company policy and on the interests and objectives of the family'.

According to Sethi (1968) "family businesses are those enterprises managed or controlled by a group of people whose interests are tied together by a family unit". Sethi does not consider the close identification of the firm with at least two generations. Davis (1983) has given an elaborative definition of family business. "Family businesses are those where policy and direction are subject to significant influence by one or more family units. This influence is exercised through ownership and sometime through the participation of family members in management. It is the interaction between two sets of organisations, family and business, that establishes the basic character of the family business and define its uniqueness". All the three definitions given above indicate the following characteristics of family business:

i) A group of people belonging to one or more families in one enterprise.
ii) Family exercise the influence on the firm's policy direction in the mutual interest of family and business.
iii) Family control can be seen in the form of ownership or in the form of management of the firm where family members are employed on key positions.
iv) The succession of family business goes to the next generation.

In essence, family business is one which is substantially controlled and/or managed by members of family and is succeeded by the next generation.

Activity 1

a) Take a survey of the small enterprises in your area/locality. How many of these are family owned enterprises. Do these enterprises fall into the category of family businesses as described by Davis.
b) What are the characteristics of these family based businesses which set them apart from non-family based business.

2. Report of the Monopolies Enquiry Commission, Government of India, Delhi, 1965, p. 122.

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16.4 FAMILY CONTROL

In the case of proprietorship and partnership, family control is exercised by the direct participation of family members in ownership and management of the firm. In the corporate sector, forms and means of control are variedly applied by families. Three types of control are possible. In the corporate sector, these are: ownership, operation and management. Ownership control is normally held by holding a sizeable block of equity. This form of control represents the voting power of family members. This form of control is a necessary condition to exercise the other two forms of control, i.e. operational control and management.

Operational control is said to have taken place when all key positions at different levels are manned by family members. Under this control family members have decisive power and if professionals are hired, they merely give advice to family members.

Management control is exercised through a Board of Directors where family members are represented. The family members as directors determine the corporate objective and major policies of the firm. A firm may be subject to one or all the three types of control.

To determine whether a family has control over the corporate firm or not, Dutt Committee on Industrial Licensing used effective equity as the basis of control[3]. Effective equity was computed as total equity less all categories of passive shares. A family's maximum share out of the effective equity indicated the power to control.

In some cases, power of control is gained on the basis of family reputation. The shareholders entrust the power of control to a particular family, mostly known as business house or industrial house. In such a case, the family or business need not hold a majority of shares.

Different means are used to gain control over existing business such as interlocking of Board of Directors or inter-corporate investment or purchasing the controlling block of share holding in open market.

Activity 2

With respect to the enterprises you studied for Activity 1, describe the ways in which family control is exercised in these enterprises.

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3. Report of the Industrial Licensing Policy Enquiry Committee, Government of India, 1969.

16.5 VIABILITY OF FAMILY BUSINESS

Family business is the most traditional form of business enterprises. Despite the development of various other forms of enterprises, the family form of business enterprise still dominates. Those who are advocates of professional management argue that the traditional family values of enterprise stability often clash with changing economic goals of sustained investment and growth. They further argue that the traditional family structure is vulnerable in the context of increasing environmental complexity and turbulance. As against this family business provide benefits which are rarely available to professionally managed firms. Entrepreneurship, dedication, commitment, family reputation, integrity, leadership and initiative are the some of very important qualities of family business. The question whether family business is a viable proposition in the present context is reasonable enough to be raised here. To answer this, let us discuss the positive and negative sides of family business.

Negative Side

The intervention of family in the management of the firm is often considered unhealthy and unprofessional. This affects the organisational efficiency and performance in many respects. Some of the commonly occurring negative effects are discussed here.

Nepotism is one of the marked features of family business enterprises. The blood relationship determines the entry into the business and holding of key positions. Merit becomes secondary and even an insignificant criterion for promotion. This affects the loyalty and commitment of hired professionals. The inefficiency of relative-employee is often covered up by the efficient performance of non-relative employees. This ultimately make the total functioning of organisation inefficient.

Overlap between business and family goals is another feature of family business. Logically, the goal of the enterprise is oriented to fulfil the interest and achievement of the family.

This, many a time contradicts the survival and growth goals of the firm. Family members very often pursue their personal goals at the cost of sacrificing growth opportunities of the firm. This threatens the long term survival of the firm.

Family rigidity is the third feature which imposes poor profit discipline. Family members very often prioritize certain aspects of firm's functioning on the basis of family value or family decision. For example, family value is to create a good social image which requires giving to employment to needy people may affect the profit of the firm. Many times, family members unduely support their pet projects, no matter how profitable they are.

Succession is the fourth feature of family. The continuity of family is achieved by way of handing over the charge of the firm to the next generation. Very often the successors are selected using blood relation as only criterion. They may not be and may not have any experience of running a well established business firm. In the want of proper succession a good number of family businesses get into trouble and sometime are led to closure of business enterprises.

Positive Side

Family, which is considered obstructive to the business performance is also considered a major source of strength and support in many respect. Some of the advantages of family business are discussed here.

The basic premise on which family business rests is its stability and continuity which are linked from one generation to another. The long term interest of family members in the business often provides the sentiments of family solidarity and natural loyalty. Family members work with each other with greater team spirit to attain a common goal. They make personal sacrifices by taking minimum dividends from the firm and bringing in personal financial resources in the time of financial crises. Many time, business gets greater priorities under their personal needs. Loyalty and dedication of family members have been responsible for continued operation during the period of hardship.

The image and social reputation of family becomes the goodwill of the firm. It helps in establishing trust and credibility in the market. Bankers and suppliers feel comfortable in dealing with such family owned enterprises because of their good image and reputation.

Since stock holders and managers of the firm works unitedly, managers are less sensitive to the criticism based on short term performance. They enjoy a great amount of freedom and flexibility in concentrating on long-term objectives of the firm. This is possible only in family business as both stockholders and managers have mutual understanding and trust.

There are other conditions in which the choice of the family form of enterprise becomes almost essential. Entrepreneurs who have worked very hard throughout their life to build the business empire very often desire that the fruits of their hardwork must go to their families. At the same time, they have many obligations towards the family as they derived the initial capital and emotional support from the family. Therefore new enterprises adopt the family business form to satisfy family needs.

During the transition period, the founder needs trustworthy people to take care of sensitive operations as he finds it difficult to manage the business alone. He looks for family members and relatives as a source of strength to fill the transitional gap. Small firms cannot afford to hire professionals and therefore they start taking family members and relatives to provide support in the growing business. The legislative environment has also been indirectly a binding force on the founder to adopt family business to enjoy certain benefits.

The foregoing discussion highlights benefits and disadvantages of the family business system. It has also been made clear that under certain conditions, the family form of business become almost essential. As against the family business, the professional management system is being advocated. The professional management system helps transform the proprietory firm into a modern corporation in which family ownership and control are separated. It has been thought that the continuity of family business can be ensured only through professionalisation due to increasing complexity in the environment. The advocates of professionalisation observe that family business, because of its inherent weaknesses like nepotism, favouritism, rigidity and conservative policies, is likely to be vulnerable in the long-run.

Professionalisation is certainly a need of the time to ensure stability and continuity of the family business in the long-run. However, the professional management practices are not fully fool-proof in many respects. Firstly, nepotism and favouritism are also found in professionally managed companies where it is based on caste, community, regions, etc. In fact many decisions of promotions are considered on the basis of these factors ignoring merit. Professional managers are often criticised for its lack of entrepreneurial initiative which hamper the growth potential of the business. Their commitment and loyalty to the business is also doubtful as they do not have any stake in the enterprise. In fact the so-called professional managers have yet to prove professional excellence to create an image and goodwill. Moreover, the supply of professional managers is not adequate in the developing countries especially in country like India.

Despite a few weaknesses of family business, it seems family business is still a useful system to achieve pace in industrial development. The unique supply of entrepreneurial and managerial resources from the business family has been responsible for the large scale success of business houses of the country. Family business have continued to be viable even in the present context because of its ability to respond quickly to the changing needs of business by making drastic internal adjustments.

Activity 3

Take a sample of five small scale enterprises which are family based. Talk to the entrepreneur with respect to his problems. How many of these problems can be ascribed to family ownership. Can you suggest some solutions to those problems.

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16.6 FAMILY MANAGEMENT PRACTICES

To get aquainted with the family business, it is necessary to learn some of the commonly employed management practices in family business. An attempt is made to describe to be choices of management control that are available to the founder, internal work environment, organisational structure and delegation.

Management Control Mechanism: Choices

The family business consists of two systems: family and task systems. The task system is subject to the influence of the family system. The task system is determined on the basis of norms, values and principles of family and its members. The family has different options through which it can control and manage the task system. These are as follows:

i) In the first case, the founder may decide to exercise direct control on the management of the firm. This is a normal feature in proprietorship and partnership firms. Under the direct control systems, family members are given a certain number of shares with the assurance of power of voting by family members. All important decisions are taken by the founder which are binding on the other members of the family.

ii) Another choice the founder has, is to dilute his authority of direct control by consulting a few selected family members before taking important decisions. Certain areas are clearly defined where approval of the family members is needed. For example, any decision concerning capital investment needs the approval of family members.

iii) The founder uses professionals to carry out the management function. The founder clearly defines the boundaries between business and family decisions. Family members are assured of ownership control while business related decisions are taken by different heads of business.

iv) The founder may decide to place the firm under the full control of the family. Family members are involved in the early stages of enterprise development at different levels to take charge of various management functions.

Internal Environment

Family business consists of two sets of individuals: family members and non-family members. The sentiment system of the family system is at its core and made up of those individuals who are bound by emotions and loyalty. The non-family members are subject to the rules made by the family owning the enterprise.

The general feature of the family business is that the top man is surrounded by a loyal cadre of top-management personnel who are highly trusted individuals and are with the enterprise from beginning. They have normally grown with the firm and exhibit intense feeling of permanent relationship with the founder. The forces of traditions, kinship, caste and religion support the integrity of the family business. Relatives of the family members are hired and placed on key positions of the firm. They get fitted in the internal environment of the firm more easily than non-relative employees. The relatives have free access to the top man no matter at what level he is, while non-employees have to strictly adhere to the formal channel.

Decisions are taken by the family members and power to take decisions are normally centralised at the top. Professionals are hired to give technical advice and they do not possess any decision-making power.

Since relation is considered as one of the basic criteria for selecting people to top and middle levels, non-relative employees at junior levels suspect the authority of those who are at the top and feel that they do not deserve it by competence. They often complain that it is difficult for them to work productively with the non-competent family members/relatives. Competition among family members/relatives — non-relative employees normally leads to subtle rivalries amongst them. This creates a climate of poor interpersonal relations and politics.

Objectives and policy direction of family business are oriented towards the goals of the family. Therefore, the internal environment of family business is created to reinforce and perpetuate family pride and tradition.

Organisational Structure and Delegation

Normally, the organisational structure of family business is hierarchical and decision-making authority is centralised at the top. The organisation is structured on the functional basis: Functional Specialists and managers at intermediate level are often between top men and workers. In practice, the hierarchical system reduces to one-man show. As a result, formalisations are kept to a minimum. It is very often observed that no written documents are kept which details out rules and regulations and operating instructions of the organisation. Job descriptions and organisational charts are rarely available. The family business also avoids standardisation as no specific policies are clearly stated. Decisions are taken on internal judgement.

In such organisations, delegation of power does not really take place in a formal sense. Functional specialists play the role of advisers while managers at intermediate level do not really exist in practice. They are communicated of decisions for which they are responsible for implementation. However, they have no power to take decisions. Very often, family business organisations have a large span of control as almost everyone excepting workers keep reporting to the top man. To sum up, organisation and management in family business is based on personalised modes rather than professional modes.

16.7 ISSUES AND PROBLEMS IN FAMILY BUSINESS

Family business are often criticised for their lack of professionalism in dealing with environmental complexities more efficiently. Intervention of family in the business affects business-like responses to various situations of opportunities and threats. As a result, more and more family businesses are getting into trouble. Problems that most of the family businesses get into are: conflicting business and family norms; rivalry among family members, professionalisation and problems of continuity. In the past, these problems have led even the most successful enterprises into severe problems causing sometimes to collapse of business enterprises. Each of these issues and problems is discussed here:

Business vs. Family

Family businesses very often face this unique dilemma to make choice of alternatives that is best for the business against the family norms. Given this choice, decisions are very often made in the interest of the family and not business. Values, norms and principles of the family are incongruent with that of business. This leads the family business to operate under the normative ambiguity. Human resources and growth opportunities are adversely affected due to this conflict. With regard to human resources, family management due to its obligation towards the family select, promote and compensate, its family members and relatives considering the relation as a major criterion.

The family norm is to provide help to its relatives by way of giving them employment. They have to very often hire an incompetent relative against a professionally competent non-relative candidate.

Compensation is determined on the basis of the position of the relatives in the family and their needs whereas the business norm is to compensate according to one's merit and competence. Even in the case of appraisal, family members are appraised on the basis of their standing in the family.

Training and development of employees is done as per the needs of the organisation. But, in family business, it is often done on the basis of need of the family members for their own development.

Because of certain family norms or principles, a number of growth opportunities are lost. Family principle is not to have outsiders meddling in family affairs. When the growth opportunities need raising of extra capital through equity financing, the family may decide not to go for equity financing as it means loss of freedom of family in the business. Such sacrifices in the interests of family may weaken the organisation and make it more inefficient which in turn threatens survival.

Rivalry among Relatives

A number of family members of varying age and relationship participate in the family business. They very often clash with each other because of conflict of interests. This causes the breakdown of communication and creates barrier to organisational integrity.

The founder's relatives occupy top positions in the family business. The rivalry starts right from father to son and spreads soon among brothers and other relatives. The father-entrepreneur normally considers his business as an extension of himself and only source of power. Despite his being consciously aware of the need to groom his son to ultimately take over the business, he never gets down to delegate the authority to his son. He does not even share necessary information with him nor consult him while making important decisions. He very often presumes his son to continue to follow traditional styles of management and resist any change in the organisation initiated by his son. The son, on the other hand, feels confused when he gets to know a number of decisions already implemented by his father contradicting his future plans. He feels that he is not fully equipped with required level of authority to bring in changes in the organisation. He starts feeling that his father is too protective and does not trust his ability. This rivalry often leads to infighting within the organisation.

The brother to brother rivalry is equally intense in family businesses. The rivalry is caused due to their anxiety to prove their mantle better than the other. Competition with each other often amounts to pull each other down at the cost of the organisational resources. The rivalry further gets complicated when other members of the family directly or indirectly favour one of them. This further leads to the complication as one of them carries the feeling of unjust and undue favouritism. Under such circumstances, a few family members can even take actions which may lead the firm into disaster.

Rivalry among relatives often leads to factional decisions that spring up in the organisation as the non-relative family starts choosing family members with whom they want to be identified. Many a time, non-family employees do not want themselves to be involved in a family fight until it is restored. This can paralyse the working of the organisation.

Such rivalries are the peculiar phenomenon which obviously arise owing to clashes of interests and ego. The organisation become directionless. Even the founder becomes helpless to resolve such conflicts as every member tries to defend his action. Slowly the business moves towards distability and finally becomes sick.

Problem of Continuity

Every family business has to face the problem of continuity or succession when the original founder retires or dies. There has to be someone to take the charge of the business to ensure continued inheritance to the next generation. It has been noted that even the most successful business firms have suffered a setback due to improper succession or non-availability of competent successors. In the U.S., it is estimated that only 30% family owned enterprises continue to exist in the second generation and only 15% in the third[4].

Unfortunately, the founder has almost no choice in the selection of the successors. The successors are selected on the basis of blood relationship no matter how competent the successor is in running the business. In fact, in most of the cases, the prospective successor is ignorant of business experiences and does not possess entrepreneurial abilities. Further, the inexperienced successors often start from the top and therefore remain unaware of dynamics at lower and middle levels.

The outgoing entrepreneur generally tries to groom his successor through informal on the job training. Such training has limited benefit to successor as the process of

4 Birley Sue, "Succession in Family Firm: The Inheritor's View" Journal of Small Business Management, July 1986, p. 36.

learning is unsystematic and inconsistant owing to the protective nature of the entrepreneur.

Many a time, succession is unplanned and therefore in the event of death or early retiring of the founder, the eligible successor is chosen to run the business. In such conditions, the successor is not psychologically prepared to take the charge of the business. A few family members or relatives take undue advantage of the situation and try to mislead or misguide the eligible successor.

Apart from the problem of the choice of successor, the process of succession itself is complex. The founder considers the enterprise as his own 'baby'. Despite his awareness of the need of handing over the charge to the next generation, he keeps hanging on to it. Even after his son being in the business, he does not delegate the power and continues to take important decisions. As a result, the son feels overshadowed and frustrated. The successor and the founder continue to resist each other's actions on matters concerning any change.

In the case of the second or third generation successors, when there are more than one eligible successor in the family, the distribution of assets and activities of business becomes difficult. It often results in split. If not efficiently handled the business get paralysed for want of proper settlement.

The successors often lack credibility in the organisation as blood relation has been the sole criterion. Employees often resist their authority. Efficient and loyal employees feel threatened and therefore start quitting the enterprise. Suppliers and bankers might also withdraw owing to unstable situations created by the takeover by the newcomer.

Successors are not able to replace the leadership of the previous entrepreneurs. They are often resisted for any initiation of change in the organisation.

Because of the peculiar problem of succession, even the most successful business have suffered serious setbacks.

Professionalisation in Family Business

It is argued that the family business system is desirable at the stage of enterprise initiation and survival. But when the business starts growing, it is desirable to replace family management with professional management. The traditional value oriented family management may clash with economic goals of growth. In the wake of increased competition and complexity, the traditional organisational structure and decision-making system is more vulnerable. Family businesses very often are not adaptable to the requirements of modern industry and technological changes. Need of growth and modernisation call for adoption of professional management in family business.

Professional management consists of a team of managers whose primary occupation is providing management service without having any substantial ownership stake. Professional managers are hired for their expertise. A team of professional managers performs the function of entrepreneurship and management of the firm. The team holds key position in the firm on the basis of technical competence. Professional management is expected to achieve excellence in building a human, physical and financial resources, and capture new opportunities of growth with professional approach through research and development.

Looking to the need for professional skills to cope with growth, every family business has to consider whether to adopt professional management or not. The family managers often resist this alternative on the ground that family will have no control over the management to protect its interests. They will not be able to help their relatives by way of providing jobs in the business. The family wants to maintain its own image in society by way of following certain socially desirable values. The family members feel that the family's image will be adversely affected.

A few family businesses which have introduced professional management have not been able to cope with the transition problem. Family members continue to keep certain key positions with them. The family members make all critical decisions. Professionals are hired in the capacity of technical advisers only. They are not given full charge of the management of the firm. As a result, professionals remain largely ineffective in the organisation. Even cases where professional management has taken over, family members continue to interfere in the working of managers by virtue of ownership right. The performance of professionals is greatly hampered because of non-cooperation and lack of acceptance on the part of the family.

Family businesses are not able to respond competently to changes in environment owing to their inability to adopt professional management practices. Because of inadequate supply of professional managers, many family businesses cannot have professionals. Family businesses are vulnerable to the increasing complexity and competitiveness in the market owing to their lack of professionalism.

16.8 COPING STRATEGIES

To realise the natural resources of family business like commitment, loyalty, initiative, entrepreneurship, financial resources, family image, etc. more effectively it is essential that family business develop certain key advantages and overcome certain inherent weaknesses. Based on some of the successful family businesses, the following coping strategies are suggested:

Linking Family and Business Goals
Successful family businesses are the ones which have been able to establish the close link between family and business by clarifying that the goal of the family can be achieved only if the enterprise achieves its long term goals. This further asserts that participation of the family members would be allowed as long as it contributes to the enterprise's long term strengths. Such a stand should be made clearly at the time of enterprise initiation or when the involvement of family begins. Strategically, eliminating some amount of family participation strengthens the leadership of the family members who are in the business which ultimately result in better performance.

Recruitment of Relatives
The best managed family businesses have adopted the policies of not recruiting relative employees at all. The needy relatives are helped by the founders to find jobs elsewhere. This may be considered a too rigid policy as there may be a professionally competent person in his family or relation who would not be selected purely on the ground that he happened to be a relative of the founder. Instead of having such a rigid policy, one may have a recruitment policy stating that relatives may be considered for employment provided they stand up to the company's standards. This policy would also ensure better cooperation of family and relatives. At the same time, business norms are not sacrificed in the interests of the family.

Avoidance of Nepotism
In family business, family members as employees get several undue benefits. In order to avoid this, the successful businesses adopt firm personnel policies applicable to both relatives and non-relative employees. It may be clearly stated in the personnel policies that one may be given an opportunity to work in the business because of the relationship factor but his growth within the firm would depend solely on his competence and merit. Relative employees, like non-relative employees, are subject to performance evaluation which would be carried out by independent people. This would greatly help the family business to avoid nepotism and favouritism within the organisation.

Task Structuring
It will be unrealistic to imagine a family business, however successful it is, to remain away from certain inherent issues pertaining to the family. It is also possible that despite all possible efforts to avoid, a number of family issues in business, may continue to remain unresolved. In such a case, to save the business from possible consequences, the primary task structure of the organisation may be designed in a manner to minimise the negative effects on its performance. A number of strategies for task structuring are suggested here:

i) The founder must try to identify those critical operational activities which need to be adequately supported to ensure at least the survival of the firm. He may structure them in such a manner that all important operations continue to take place without any disturbance despite pertaining conflict amongst the family owners-relatives. He may sanction powers to the competent people who need not have go to any of the family members for frequent approvals as long as they are carried out as per the guidelines.

ii) The firm must create reserves to meet any contingencies occurring owing non-cooperation or indigating of family members. They could be extra staff to compensate the possible loss of work because of incompetency of family members to carry out a given task.

iii) While carrying out the structuring of the task system, those areas should be identified where conflicts among family members is likely to arise. In these areas more professionals may be employed. At the same time, family members may be entrusted with those areas where the chances of conflict are less.

iv) The founder should take extra care to keep morale and motivation of the employees so high that they continue to remain committed and loyal to the firm. They are likely to be the only individuals who can be entrusted with high level of responsibility in times of conflict for ensuring smooth functioning of the organisation.

v) Very often, the founder refuses to accept certain lapses in the organisation which are results of family issues. This leads to a state of confusion in the organisation resulting in family members blaming each other for poor performance.The founder should accept certain given problems and issues as weaknesses because of family based management system. This would help avoid unnecessary anxiety and politics in the organisation.

vi) The task system should be loosely structured so that enough flexibility is built in. The bureaucratic structure is very much vulnerable during a period conflict. In the case of conflicts or blocks being created to routine functions, a middle course should be adopted.

Activity 4

From among the sample you studied for Activity 1, choose some family based enterprises which are very successful organisations. What are the coping strategies that they have followed to overcome problems associated with family management.

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16.9 SUMMARY

Classical management principles and theory have ignored the influence of family in business management and hence management practices in family business are different. Decisions and actions in family business are not always taken in the best interest of the business, it's perpetuation and growth but in the interest of family for its values and principles. Management styles are based more on personalised modes than professional modes. It is, therefore, one may suspect that family based management is more vulnerable in the face of uncertainty and complexity of environment. But in practice, things are different with family business. They have not only been able to sustain themselves in the business world but have also grown in large number. Today, family business represents the largest segment in Indian industry and makes significant contribution to the economic development of the country.

The successful performance of family business can be attributed to its natural resources like commitment, dedication, loyalty, initiative, spirit of entrepreneurship, financial strength, etc. However, family business do suffer from certain weaknesses like nepotism, favouritism, rigidity, conservatism, etc. These weaknesses can be overcome by adopting certain policies and strategies. Strategically, the founders may eliminate some amount of family participation to strengthen the leadership of those family members who are in the business. They should adopt policies to avoid recruitment of family members on the basis of relations but on the basis of competence, the personnel policies of family business should be equally applicable to both relative and non-relative employees. The task structuring should be done to minimise negative effect of family conflict and allow at least routine functions to take place smoothly in the face any major conflict or calamity.

16.10 FURTHER READINGS

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