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ENTREPRENEURSHIP DEVELOPMENT

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SYLLABI-BOOK MAPPING TABLE

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INTRODUCTION

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According to the *American Heritage Dictionary and Webster's New World Dictionary*, an entrepreneur is 'A person who organizes, operates and assumes the risk for business ventures.' Entrepreneurship is what entrepreneurs do. These days, entrepreneurs can be seen in many fields—not just as profit makers but also in NGOs; educational fields; economic development; and as active players in the polity of state, country or even the world. Entrepreneurship is concerned with the development and coordination of entrepreneurial functions. It is abstract whereas entrepreneurs are tangible persons. Entrepreneurship is a role played by or the task performed by an entrepreneur. The central task of the entrepreneur is to take moderate risks and invest money to earn profits by exploiting an opportunity.

Entrepreneurship development is one of the most important subjects today. Entrepreneurship development plays a critical role in encouraging young individuals to become self-employed by setting up businesses of their own with the help of government funding.

In a rapidly changing socio-economic and socio-cultural environment, entrepreneurs have gained significance in the field of economic growth. Entrepreneurship is one of the most important segments of economic growth which always looks for higher achievements and plays an important role in personal, economic and human development. An entrepreneur, if properly trained and developed, is an important participant in the process of economic development and is capable of inspiring confidence in people. A good entrepreneur always tries to motivate people in order to cater to the economic goals of an organization.

This book, *Entrepreneurship Development*, has been designed keeping in mind the self-instruction mode (SIM) format and follows a simple pattern, wherein each unit of the book begins with the Introduction followed by the Objectives for the topic. The content is then presented in a simple and easy-to-understand manner and is interspersed with Check Your Progress questions to reinforce the student's understanding of the topic. A list of Self-Assessment Questions and Exercises is also provided at the end of each unit. The Summary and Key Words further act as useful tools for students and are meant for effective recapitulation of the text.

BLOCK - I
BASIC CONCEPT OF ENTREPRENEURSHIP

*Concept of
Entrepreneurship*

**UNIT 1 CONCEPT OF
ENTREPRENEURSHIP**

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Structure

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- 1.1 Objectives
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1.0 INTRODUCTION

The word entrepreneur is derived from the French verb '*entreprendre*', which means to attempt, to undertake, to contract for, to try in hand, or, to adventure. In the general sense, the word applies to any person who enters into a new project or tries a new opportunity and takes from it the profits or the losses. The definition of an entrepreneur as given in the American Heritage Dictionary and Webster's New World Dictionary are similar and reflects this behaviour:

‘A person who organizes, operates, and assumes the risk for business ventures.’

The distinction between a small businessperson and an entrepreneur is subtle. The reason is that the term 'entrepreneur' is understood to mean people who come up with new ideas, start enterprises based on those ideas, and provide added value to society based on their independent initiative. What distinguishes the two are as follows:

- Vision for growth
- Commitment to constructive change
- Persistence to gather resources
- Energy to achieve unusual results

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Entrepreneurs invest in 'capital' (capital goods and/or land) that is used in the process of production. They buy factor services or factors in the present, for products that are to be sold in the future. Their aim is to look for areas where more earning is possible than the going rate of interest. This type of entrepreneur has also been referred to as 'capitalist entrepreneur'. We will be using the term 'entrepreneur' to reflect this type of entrepreneurship.

This unit deals with entrepreneurship, its concept and the role it plays in economic development. It discusses the functions and types of entrepreneurship along with development of women and rural entrepreneur.

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the meaning, nature and characteristics of entrepreneurship
- Examine the functions and types of entrepreneurship
- Discuss in detail the three phases of the EDP
- Explain the measures taken to provide support and financial assistance to women in India
- Analyse the main goals of SEWA

1.2 DEFINITION, NATURE AND CHARACTERISTICS OF ENTREPRENEURSHIP

The term 'entrepreneur' is often used interchangeably with 'entrepreneurship'. But conceptually they are different. An entrepreneur is an individual, whereas the activities for starting up the enterprise are collectively referred to as entrepreneurship. Entrepreneurship is the tendency of a person to organize his own business and run it profitably, exploiting the qualities of leadership, decision making, managerial calibre, etc. Entrepreneurship is concerned with the development and coordination of entrepreneurial functions. Entrepreneurship is a role played by or the task performed by an entrepreneur.

Definition

The word 'entrepreneurship' typically means to undertake. It owes its origin to Western societies. But even in the West, the meaning has undergone changes from time to time. In the early sixteenth century, the term was used to refer to army leaders. In the eighteenth century, it represented a dealer who bought and sold goods at uncertain prices. The famous Austrian Political Economist Joseph Schumpeter used the term 'innovator' for entrepreneur. Entrepreneurship is recognized all over the world in countries such as USA, Germany, and Japan and in developing countries like India. From the economic standpoint, initially

the economists used to discuss three factors of production: (a) land, (b) labour and (c) capital. To bring these three factors of production together a new factor of production is recognized, i.e. 'entrepreneur'.

Entrepreneurship is the process of creating or seizing an opportunity, and pursuing it regardless of the resources currently controlled.

Entrepreneurship = Entrepreneur + Enterprise

Importance of Entrepreneurship

Entrepreneurship is the essence of free enterprise because the birth of new businesses gives a market economy its vitality. Most economists today agree that entrepreneurship is a necessary ingredient for stimulating economic growth and employment opportunities in all societies. By its very definition, it is entrepreneurs who bring new processes to fruition, coordinate economic activity, combine labour and capital in new or proven ways, and create their own individual fortunes out of which the economy's overall, aggregate direction emerges. Entrepreneurship transforms ideas into economic opportunities. That is the crux of entrepreneurship. Innovative entry by entrepreneurs is the force that sustains long-term economic growth. History of the Industrial Revolution in Europe is a pragmatic example of how economic progress has been significantly advanced by entrepreneurship.

In most developing countries, successful small businesses are the prerequisites of income growth, job creation, and poverty reduction. In India, private sector development in the recent decades has been a powerful engine of economic growth and wealth creation. It has been crucial for improving the quality, number and variety of employment opportunities for the poor.

It has become increasingly apparent, over the years, that entrepreneurship makes an important contribution to economic development. Government support for entrepreneurship is a crucial strategy for economic development, for two basic reasons that are as follows:

- (i) Economically, entrepreneurship stimulates and revitalizes markets. The formation of new business leads to job creation and has a multiplying effect on the economy.
- (ii) Socially, entrepreneurship empowers citizens, generates innovation and creates opportunities for new ways of doing things. These changes have the potential to integrate developing countries and give them greater capacity to compete in the global economy.

There is another important, but usually overlooked, advantage to having entrepreneurs control the economy's overall direction. Central planning has the disadvantage that when the national planners are wrong, the entire economy suffers. As entrepreneurs make their decisions individually, the decisions are decentralized. Such decisions minimize the harm that can be caused to the entire economy through making of poor choices.

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Nature and Characteristics

Entrepreneurship appears in different sizes. It can be found in large corporations as well as in small retail shops. Entrepreneurship can present itself under various forms. It may be a force that motivates a scientist who assigns economic meaning to his or her lab activity. It can also be found in the old-time peddler who was an able salesperson like today's highly educated manager who oversees a large corporation with the help of techniques he learned in a business school.

Entrepreneurship is seen in people who are naturally alert, and when they recognize ideas for new products or services, they have a desire to see those ideas realized. They may recognize the need for a service or a product that is currently unavailable in the market through a leisure activity, hobby, or just everyday life. They have an idea, which they turn into a viable business, giving a lot of energy and time to convert the idea into a full-time or a part-time business. The nature, scope and extent of commerce are so extensive that the traditional and historic concept of entrepreneurship does not yield any pattern of what entrepreneurship is. However, there are some characteristics that are unique to entrepreneurship, which are as follows:

- (i) **Decision-making:** The decision-making ability of a person is one of the fundamental features of entrepreneurship. This means the entrepreneur has the ability to choose a course of action from multiple alternatives to achieve the desired result. Decision-making involves decisions which have components of both risk and uncertainty; therefore, it is a critical characteristic of entrepreneurship.
- (ii) **Accepting challenges:** Entrepreneurship requires a commitment to an idea and the ability to accept challenges and disappointments amidst risk and uncertainty. The entrepreneur has to accept the challenges and convert these into viable business opportunities.
- (iii) **Risk taking:** The ability to assess and take risk is an important characteristic of entrepreneurship. This means not only to extract profit, but also assuming responsibility for loss that may occur due to unforeseen circumstances or poor judgement. Entrepreneurship flourishes in individuals with deep insight who can analyse situations objectively and reduce risks to enhance profit.
- (iv) **Building organization:** Organization building skill is a critical requirement for successful entrepreneurship. Entrepreneurship has to be characterized by the initiative and skill that can build organizations, delegate authority, and provide proper leadership.
- (v) **Skillful management:** Entrepreneurship involves management skills. For effective management of an enterprise, entrepreneurship is characterized by the entrepreneur managing the idea and identifying new opportunities and threats.

- (vi) **Innovation:** Innovation is one of the most important characteristics of entrepreneurship. It is the capacity to innovate that separates a good entrepreneur from a bad one.
- (vii) **Mobilization of resources:** Entrepreneurship involves resource mobilization. This is a fundamental characteristic of entrepreneurship. Resources are required to carry out activities that result in the goals being accomplished. Entrepreneurs have to have an innate capability to mobilize resources to put their ideas into operation.

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Check Your Progress

1. What is the crux of entrepreneurship?
2. Why is innovation considered one of the important characteristics of entrepreneurship?

1.3 FUNCTION AND TYPE OF ENTREPRENEURSHIP

In setting up an enterprise, an entrepreneur has to get involved in multiple tasks and multiple things, right from identifying entrepreneurial opportunity to organising resources to overseeing all business functioning.

Here is a list of some of the important functions that need to be performed by an entrepreneur:

- **Realisation of opportunity:** The key thing that entrepreneurs first try to figure out is what business opportunity is right for them. Of course, there are many sources of opportunities in almost every sector of business. A common man may not recognise these but an entrepreneur will sense those opportunities with imagination and creativity. An entrepreneur must be able to spot what he or she can do better in an existing business or find an opportunity for a new offering.
- **Giving shape to ideas:** The next step after conceptualising ideas is to turn those ideas into action. This requires a unique combination of creativity and planning. As an entrepreneur you need to use all available resources, knowledge and information to execute something that you believe has the potential to be fruitful as a successful business venture.
- **Assessing potential:** While it is the creativity and innovation that identifies an opportunity, it is the analytical skill that helps entrepreneurs in assessing the actual potential of that business. The entrepreneur does meticulous market research on the purposed product or service to assess the feasibility and comes to a firm decision before preparing a business plan.
- **Consolidation of resources:** An entrepreneur has to organise and set up various resources in terms of capital, land, equipment, infrastructure and

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managerial skills. As an essential function of entrepreneurship, the entrepreneur has to perform the function of planning and coordination in order to ensure the availability of all kinds of resources as initial investment.

- **Setting up of the enterprise:** After bringing together all the resources, the entrepreneur has to fulfil some legal formalities, obtain a place for the enterprise and set up the facility, like installation of machinery, and other related activities to bring the whole business unit to function.
- **Overseeing the enterprise:** The entrepreneur is responsible for running the enterprise as a whole. He has to oversee everything from the start-up process to marketing of each product and service for profitability. An entrepreneur who starts a business also has to take up the job of a typical manager in nurturing the company.

Furthermore, economists have classified entrepreneurial functions into five broad categories. The functions we have already discussed, in some way or others, come in the domain of these categories.

1. **Bearing risk and uncertainty:** Starting a new business venture involves many risks and uncertainties which can either be insurable or non-insurable. Although the entrepreneur plans his future course of action, he or she also assumes risks and prepares for the losses in any unforeseen future situation that may occur due to any of various factors like market fluctuation.
2. **Organisation building:** Organisation building includes various organisational functions necessary for the preliminary set up as well as long-term financial performances. In the beginning, an entrepreneur has to bring together different factors of production: man, capital, material and other resources. In this way, he or she has to perform the job of continuous planning, coordination and control.
3. **Practice of innovation:** An entrepreneur must be innovative enough to survive in a volatile market. As an innovator, an entrepreneur methodically analyzes business ideas, market trends and opportunities that can be exploited to make profit. Social ecologist Peter Drucker explains 'innovation' as the means by which an entrepreneur exploits change as an opportunity to create a different product or service.
4. **Managerial activities:** Organising encompasses activities such as identifying and classifying work to be performed, assigning responsibility to individual or group and coordinating various stages of business operation. By supervising multiple yet core activities of business, an entrepreneur ensure the smooth operation of the enterprise.
5. **Decision making:** Economists have described entrepreneurial decision-making as one of two important characteristics that eventually set the course of business. The first being doing things in 'a new and better way' and the

second being decision making under uncertainty. According to A. H. Cole, an entrepreneur is a decision maker who holds responsibilities, such as:

- determining the objective of business enterprises
- procuring of new equipment and infrastructure
- introducing advanced technology to improve the quality of product
- developing market for the product

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Types of Entrepreneurs

The term 'entrepreneur' is fairly broad in definition. So, it is in the possibility to categorise this further with different types of entrepreneurs. In fact, it is the business personality types, traits and characteristics that together blend with the entrepreneur's business to make a particular type of entrepreneur.

Starting a business and growing this further with a set of goals needs much effort and business insight. Every entrepreneur is not blessed with the same abilities and the personality type of entrepreneurs has been placed in nine types.

These nine key personality types are based on the popular Enneagram's structure (the 9-point circle) which has been used to understand, analyse and influence the strategies of behaviour of individuals, organisations and cultures. This is probably the most effective way to analyse and improve personality types and organisational behaviour.

Personality types

1. The Improver: They are principled, purposeful, self-controlled and perfectionist. They can also be called reformers, who are focused on using their resources for improving their own world and surroundings. Also, they value business ethics the most in running any type of business activity.

Entrepreneurs of this category are of the opinion that the morally correct company and business with ethics will be rewarded with working on various noble causes. They are good at influencing people on how to be more efficient and do things correctly. In addition, they are over critical of others and themselves. Nevertheless, they are champions of wise decisions and responsible behaviour.

2. The Advisor: Entrepreneurs with this type of business personality are generous, demonstrative, people-pleasing and possessive. They are very sensitive to the needs of others and believe that the customer is king and will do everything possible to please their customers.

Companies built on this value offer all kinds of assistance to customers. Their business is solely based on the customer-oriented approach. While, at their best, they are generous and helpful, on the downbeat they often become inattentive to their own needs with personal over-involvements.

3. The Performer: The Performers or achievers are extremely image-conscious and brand oriented. They tend to be ambitious, focused, and competitive. They

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know how to work effectively to gain the goodwill of customers. They are hardworking, workaholic and so they like to be recognised. Their keenness in pursuing their entrepreneurial dream also makes them admirable and often role models for others.

4. The Artist: Entrepreneurs with this business type of personality are highly creative, intuitive and individualistic. Their business is known for its uniqueness and they are always in search of something new. In a sense, they try to leave their personal imprint whenever they find some room for improvement.

Individuals with inborn artistic sense fall into this category. We can find entrepreneurs of this trait in businesses like web designing and in ad agencies. With artistic nature, they tend to nurture their business with in-depth style, and an inimitability personal dimension.

5. The Visionary: A visionary always plans ahead for everything, with great foresight. Visionaries are detail oriented and mostly follow curiosity. Even though they are perceptive and innovative, they find themselves very isolated in following their dreams. On the finest side, they are pioneers of coming up with strikingly new ideas that stand out for a long time.

6. The Analyst: They are very committed and deeply engaged in activities of their expertise. Usually, people of this trait dislike taking risk and ask for consensus. They believe in working together as a group to find best solutions to the various problems that arise.

7. The Fireball: Business people with such type of personality are very spontaneous in decision making and tend to shape ideas with versatility. A business owned by a Fireball is full of action and positive results that lead to improved productivity.

One more characteristic of this business personality is that it goes with eagerness to acquire things. However, if you find yourself inclined towards this personality type, it is important to balance your impulsiveness with better business planning.

8. The Challenger: The Challengers are self-confident, decisive, commanding and wilful people. They have the essence of entrepreneurship and the ability to lead the world with great leadership skills.

On the best part, they love to take up new challenges while on the downbeat they want to work on their own and don't like to share leadership. So, if you possess such a business personality, you have a very good chance of being a successful entrepreneur.

9. The Healer: People with this personality type are very caring and have a healing attitude towards business. If you are a Healer, it is very likely that you enjoy working with others in an atmosphere of harmony and peace. Such people are always in search of stability and prefer avoid conflict in situations.

Entrepreneurs of this nature provide stability to their business. Overall, they are calm, encouraging, agreeable and complacent. They are best in

negotiating any difference and bringing everyone together for the betterment of their endeavour.

*Concept of
Entrepreneurship*

Each business personality has some unique characteristic to succeed in the competitive world, provided the entrepreneur remains focused on the goal of the enterprise. The nine personality traits can guide you in understanding your own personality and plan accordingly for a successful business to suite your specific personality type.

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Check Your Progress

3. What are the responsibilities of an entrepreneur as a decision maker?
4. State the characteristics of entrepreneurs who have the personality type of an Advisor.
5. What are the negative traits of the Challenger?

1.4 QUALITIES OF SUCCESSFUL ENTREPRENEURS

Entrepreneurship is not just about starting a business or making profit out of it. It is about having a corporate mindset, and adopting an approach and character that brings diversity to the field of business. Entrepreneurs are disciplined, goal-oriented, confident, open-minded, self-starters. Let us have a look at some top most qualities that successful entrepreneurs share

1. **Discipline:** In business or any field of our work or even in our daily life, one has to be disciplined enough to take timely decision in order to accomplish set goals. Successful entrepreneurs are disciplined towards their objective and constantly striving to achieve it.
2. **Confidence:** Entrepreneurs many times perform their function under situations of risk and uncertainly. However, they are confident in their decision making even during the times they anticipate some risk. They are confident of their ideas, their business approach and above all their conviction that they can attain what they desire.
3. **Open minded:** If you are going to be a successful entrepreneur, you should have the zeal to try new things with an open mind. You need to be open to new ideas and start realising that there is an opportunity, hidden or otherwise, in everything.
4. **Self-starter:** With an inner drive to attain success, entrepreneurs never wait for others to take the right decision in initiating something, which they believe has potential for success. They are hardworking self-starters, who set their own goals and then follow them with much honesty.

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5. **Competitive:** Nowadays, companies always strive to better their benchmark of success with an attitude of being competitive. An entrepreneur always sees ways to provide something better than any other.
6. **Creativity:** Creativity involves the aspect of developing new alternatives and finding new possibilities. Going by this, entrepreneurs many times come up with new ideas based up the existing ones. It is their creativity and tendency to create or recognise something new that sets them apart.
7. **Determination:** Entrepreneurs are persons who have a high determination to march forward. Entrepreneurs look at every defeat or at each not-so-successful action as a learning experience and as an opportunity to try again. Determination is what keeps them motivated; successful entrepreneurs always live with a 'can do and get it done' attitude.
8. **Strong communication skills:** Entrepreneurs have strong communication skills to market their ideas. Most successful entrepreneurs know how to convey the right message that not only helps in motivating employees but also creates a positive atmosphere conducive to the overall growth of the business.
9. **Strong work ethics:** Good business is all about ethical behaviour. An entrepreneur is someone others look up to. He is the role model for employees. To enhance the image and the stature of the business as a whole, a successful entrepreneur always does the ethically and morally right things.
10. **Passion:** Entrepreneurs are passionate about their work. Keeping the passion or enthusiasm alive in pursuing dream is one of the most important qualities of a successful entrepreneur.

Other traits include determination, enthusiasm, hard work and genuine love for work.

EXHIBIT 1.1

The top 10 traits of successful, creative businesswomen

With inequality at the workplace, unequal pay and hardly any women at the boardroom level, businesswomen clearly still have challenges to face. With this in mind, if you're a woman (or indeed a man) who wants to start your own business, read the following top 10 traits that I believe make a successful entrepreneur.

Self-belief

Look at any successful businesswoman and you will discover how much they truly believe in themselves. Self-belief is probably the single most important trait possessed by any successful entrepreneur. If you don't believe you can succeed, then you won't get very far.

In the words of Mary Kay Ash who founded Mary Kay Cosmetics: "If you think you can, you can. And if you think you can't, you're right." This was a

woman who continued to build her business, just a month after her husband's death.

Ambition

Facebook's chief operating officer Sheryl Sandberg recently challenged women to have the courage to be as ambitious as men. While this makes me cringe because all the women I've ever known are ambitious, it's definitely a trait that both successful men and women possess.

You have to really want something if you're going to succeed. And you should never settle for second best. Always strive to push forward. Always aim for the top. What's stopping you?

Confidence

Confidence is essential if you want to win clients and build a profitable business. Confidence will win people's respect, earn their trust and gain you a solid reputation.

When walking into any room, hold your head up high and stand tall. When greeting people for the first time, smile, shake their hand, hold eye contact – be confident. And if you're having an 'off day' repeat positive affirmations in your head. Take inspiration from female aviator Beryl Markham: "Success breeds confidence."

Passion

Successful female entrepreneurs are always passionate about what they do because they tend to create businesses around the things they enjoy.

Oprah Winfrey suffered a difficult childhood, then built a career around her passion to help others. Anita Roddick was passionate about environmental and social activism and her company, The Body Shop, was the first to prohibit the use of products tested on animals.

Find your own passion, believe in it and turn it into something you can really be proud of. As Anita Roddick once said: "To succeed you have to believe in something with such a passion that it becomes a reality."

Humility and a willingness to learn

You cannot rest on your laurels when you run your own business. The creative industries are always changing, so you will constantly need to keep up and innovate. Successful female entrepreneurs know this and will work hard to learn and improve all the time. They'll read books, go to workshops and be willing to learn from others.

Successful businesswomen will always be humble. They'll never be afraid to admit they don't know everything and will always strive to boost their skills.

Sense of purpose

There is no point in starting a business unless you possess a strong sense of purpose. You have to believe that you are destined for great (and good) things.

Just look at women like Coco Chanel or Oprah Winfrey – they believed they had a purpose in life. They wanted to make a difference, and they certainly did.

To be a successful female entrepreneur you have to believe in yourself and believe that what you are doing is making a difference. That strong sense of purpose will be reflected in your business, which will only stand the test of time.

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Assertiveness

To be a successful businesswoman you have to be assertive, otherwise people will not respect you. Convey assertiveness by being fearless, speaking with authority and purpose. Adopt a confident manner, deal with any criticism rationally and be calm, cool and considered.

Hard work

Singer Marsha Evans once remarked: "You can have unbelievable intelligence, you can have connections, you can have opportunities fall out of the sky. But in the end, hard work is the true, enduring characteristic of successful people." Even Margaret Thatcher said: "I do not know anyone who has got to the top without hard work. That is the recipe."

Hard work is the secret to success. You have to be prepared to work long hours and sacrifice your spare time to build up a business.

Bravery

Whether you're a man or woman, it takes guts to run a business and deal with all the difficult challenges you will undoubtedly face.

You have to constantly push yourself out of your comfort zone to move forward, boost confidence and ultimately succeed. This means you have to take risks and accept that when things go wrong, you can always survive and turn things around. Be brave and you will never look back.

Persistence

Starting a business is one thing, keeping it going is another matter entirely. To be a successful businesswoman, you have to be persistent and never give up.

Granted, there will be days when you feel like sticking your head in the sand. But when you're feeling down, remember why you went solo in the first place. Remind yourself of all the things you've achieved. Stick at it because the next best triumph could be just around the corner.

Source: <http://www.guardian.co.uk/culture-professionals-network/culture-professionals-blog/2012/mar/08/successful-businesswomen-top-ten-traits>

Accessed on 16 June 2012

Check Your Progress

6. What are the qualities of a successful entrepreneur?
7. Why is it important for entrepreneurs to have strong communication skills?

1.5 PHASES OF EDP

Success in any venture depends upon certain qualities such as foresight, knowledge, sanguinity, hard work, determination and efficient management of the promoter. Some individuals have these qualities by virtue of being born in a particular family, whilst others acquire them from the environment through education, training and experience. Entrepreneurship does not emerge or develop on its own. Its emergence and development depends on various economic and non-economic factors. Economic factors comprise land, labour, capital, raw material and market

whereas non-economic factors include social climate for entrepreneurship, and the need to achieve social mobility, status and respect. Entrepreneurial development has become a subject of great importance in all developing and developed economies of the world. Entrepreneurial talent can be nurtured by undertaking various Entrepreneurship Development Programmes. An EDP may be defined as a programme that is designed to help an individual strengthen his entrepreneurial motive and to acquire skills and capabilities so that he can play his entrepreneurial role effectively. The thrust of an EDP is to prepare a person for his entrepreneurial career, make him capable of perceiving the opportunities and exploiting them successfully for setting up his own enterprise. Thus, a trained entrepreneur becomes a catalyst of industrial development economic progress.

The process of Entrepreneurship Development Programme (EDP) involves the following sequence:

1. Identification of prospective and right candidates
2. Training and developing their entrepreneurial capabilities
3. Linking suitable projects with each entrepreneur
4. Equipping them with basic administrative, financial and managerial capabilities
5. Providing follow up support in establishing the venture

An EDP consists of three phases:

1. Pre- training phase
2. Training phase
3. Post training phase

Pre-training Phase

This phase is intended to carry out the preparations required to launch a programme. The activities included in this phase are:

- (i) Creation of infrastructure for training
- (ii) Preparation of training syllabus
- (iii) Tie up with Guest Faculty for training
- (iv) Selection of necessary tools and techniques to select suitable entrepreneurs
- (v) Formation of selection committee for selecting trainees
- (vi) Arranging publicity media and campaigning for the programme
- (vii) Developing the application form
- (viii) Pre-potential survey of opportunities available in the given environmental conditions
- (ix) Selection of potential entrepreneurs
- (x) Arranging for inauguration of the programme

The identification and selection of potential entrepreneurs is the most important aspect of pre-training phase. If the trainees are not properly selected

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the entire programme can fail. The selection procedure to be adopted should be based on sound theoretical background and standard tests administered by experts. Several institutions of repute administer scientific tests such as Thematic Appreciation Test, Entrepreneurial Test, etc., which are followed by personal interviews. Besides, certain socio personal characteristics such as family background, age, size and type of family, education, and previous experience in trade should also be taken into consideration for selecting the potential entrepreneurs. When entrepreneurs are selected properly, chances of drop outs are minimized and the training becomes effective.

Training Phase

In this phase, the training programme is launched in order to carry out necessary changes in the skills, attitudes and behaviour of the participants. Motivational inputs such as psychological games, tests, goal setting exercises and role play are used for this purpose. The objective of these inputs is to enable the participants to do a self study, understand their own entrepreneurial personality and behaviour and bring about changes in self concept, values and skills, leading to positive entrepreneurial behaviour.

The other inputs of the training programme include the following:

- (i) Developing skills in identifying suitable items for manufacturing. The techniques of conducting market surveys and research are covered for this purpose.
- (ii) For organizing an industry, information on government policies and programmes is helpful to the entrepreneurs. A number of institutional agencies offer necessary financial and non-financial assistance to set up industries. The participants have to be exposed to agencies such as DIC, local banks and other financial institutions and institutions that deal with supply of equipment, raw material, etc. The procedures of applying to and obtaining assistance from these institutions are also a part of this programme.
- (iii) The training programme is developed in a way that ensures that entrepreneurs are able to develop their enterprise well. It includes study of techniques in various fields of management such as finance, marketing, production, inventory control, labour laws and taxation.
- (iv) An industrial visit to units consistent with items identified by the entrepreneur is also a part of the training programme. This enables the entrepreneur to gain practical knowledge on production processes and machines required for this purpose.

Post Training Phase (Follow Up)

During this phase a review is done of the knowledge and skills acquired during the training phase. Follow up is essential for the success of any EDP. The ultimate

objective of the EDP is to make the participants ready to start their industries. This phase, therefore, also involves making an assessment of how far the objective of the programme has been achieved.

Some of the common activities in the follow up process are as follows.

- (i) Preparing and maintaining a separate file for each trainee.
- (ii) Maintaining a card for each trainee where his progress is recorded from time to time.
- (iii) Keeping in touch with every participant through letters.
- (iv) Maintaining contact with the entrepreneurs through personal visits.
- (v) Conducting follow up meetings and maintaining a Follow up Register to ensure the success of the EDP.

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General Course Structure of an EDP

The EDP training is set up according to the training needs of participants, who are both existing and potential entrepreneurs, and industrial prospects of the area. The duration of the training programme is four weeks, and consists of six modules.

- (a) **Introduction to entrepreneurship:** This module covers general knowledge on factors affecting small-scale industries, the role of entrepreneurs in economic development, entrepreneurial behaviour and the facilities available.
- (b) **Motivation training:** Motivation training is a three-day live-in-module aimed at increasing the participant's level of achievement and confidence and developing the right attitude and behaviour towards business. Successful entrepreneurs are invited to speak about their experiences in setting up and running a business.
- (c) **Essentials of management:** This module is aimed at providing participants with basic management and technical know-how to enable them to operate their business enterprise effectively and efficiently. It consists of the following subjects:
 - i. General Management
 - ii. Marketing Management
 - iii. Production Management
 - iv. Financial Management
- (d) **Fundamentals of project feasibility study:** This ratio provides guidelines on the effective analysis of feasibility of the project in view of marketing, organization, technical, financial and social aspects.
- (e) **Organizing the business:** The purpose of this module is to enable participants to know about the environment in which they will operate their business. This covers such aspects as government incentives, industrial opportunities, policies, business laws, and regulations.

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- (f) **Plant visit:** Plant visits are necessary to familiarize the participants with real life situations in small business. Such trips also provide participants with opportunities, to learn more about an entrepreneur's behaviour, personality, thoughts and aspirations including his plans and projects.

The training method is a combination of group dynamics, lecture discussions, case studies, actual preparation of project assignment, and workshop exercise.

Check Your Progress

8. How are potential entrepreneurs identified and selected for EDP?
9. What is the ultimate objective of the EDP?
10. What is the duration of EDP training?

1.6 DEVELOPMENT OF WOMEN ENTREPRENEUR

Women entrepreneurship is a relatively recent phenomenon which came into prominence in the late 1970s. Favourable government policies towards the development of women, enhanced ratio of educated women, entrepreneurship awareness, and new opportunities are the reasons why more and more women are venturing as entrepreneurs in all kinds of businesses, economic and other useful activities.

Women entrepreneurship in India has come a long way from *papad*-and pickle-making to making forays into engineering and electronics. Nowadays elite women in cities are making a mark in non-conventional fields such as consultancy, garment exports, interior designing, textile printing, food processing, chemicals, pharmaceuticals, etc.

There were 3 lakh women entrepreneurs in India constituting 11.2 per cent of the total entrepreneurs in 1995–96. Nearly 8 per cent of small-scale industries are run exclusively by women entrepreneurs. As per the Sixth Economic census, as of (2013-14), there are close to 8.05 million (around 80 lakh) women entrepreneurs.

Women entrepreneurs in India can be classified into three categories:

- i. Women who reside in cities generally have adequate education and professional qualifications. Such women can become entrepreneurs, and are able to engage in medium and large industrial units and non-traditional establishments. This type of entrepreneurs are not confined to commercial activities but venture into fields such as electronics, engineering and services. This type of entrepreneur has the determination, drive, creativity and innovativeness for taking on the challenging role of entrepreneurship.

- ii. The second category consists of middle-class women who have the education but lack training. These women have become entrepreneurs due to the pull and push of traditional and changing values. They are mostly engaged in handicrafts and cottage industries and produce low value added items such as knitted garments, garments, doll and toy making, etc.
- iii. The next and last category of women entrepreneurs are those who take up business enterprise to tide over financial difficulties when responsibility is thrust upon them due to family circumstances. This group of women entrepreneurs is illiterate, financially weak and is engaged mostly in family business such as horticulture, fisheries, nursery, handlooms, etc.

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Support and Financial Assistance to Women Entrepreneurs in India

A number of institutions and agencies have been set up to develop entrepreneurship in women in India for purposes of training and giving financial and marketing assistance. Public sector banks and state financial corporations provide loans to women entrepreneurs. Schemes such as Self-employment for Educated Unemployed Youth and Mahila Gramodyog are implemented to develop women entrepreneurs. Assistance under the District Rural Development Agency is provided to women entrepreneurs. Under the Jawahar Rozgar Yojana Scheme, 75 per cent of the funds are provided by banks and 25 per cent by the Women's Finance Corporation, out of which 20 per cent is provided as subsidy to women entrepreneurs. The Mahila Udyam Nidhi Scheme was introduced by SIDBI to provide equity assistance to set up new industrial projects by women. Under the Prime Minister's Integrated Urban Poverty Eradication programme, the Women's Finance Corporation provided financial assistance to set up units for less than ₹ 10 lakh. Self-help Groups set up by women in villages are financed by commercial banks. The Self-help Group is a group of rural poor with a homogenous background and interest, who voluntarily come together with intent to carry out savings and credit operations and other economic activities for mutual benefit.

As of 2020, there are many different programmes operational in the country for the promotion of women entrepreneurship including initiatives of Ministry of Skill Development and Entrepreneurship, Prime Minister's Employment Generation Programme, Niti Aayog's Women Entrepreneurship Platform, and skill development through Rural Self Employment and Training Institutes under the Ministry of Rural Development.

Stree Shakti Package is a scheme run by State Bank of India to provide concessions on loans along with low floating rate of interest to women entrepreneurs. Training of Rural Youth in self employment, Action Plan and several other schemes provide financial support, technical assistance and guidance to women entrepreneurs.

The Government of India has organized a number of workshops on Trade-Related Entrepreneurship Assistance and development for the benefit of women

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entrepreneurs. The government seeks to empower women in rural and semi-urban areas through development of entrepreneurial skills, elimination of various constraints faced by them and by strengthening the trade support network.

The Federation of Societies of Women Entrepreneurs is engaged in promoting women entrepreneurship by:

- (a) Providing marketing assistance to market their products,
- (b) Providing effective interaction with government officers, and
- (c) Evolving suitable guidelines from time to time for the promotion of entrepreneurship among women.

The National Research Development Corporation has set up a number of technology demonstration-cum-training centres to provide expertise and resources to women entrepreneurs in respect of new technology.

The National Alliance of Young Entrepreneurs, National Institute for Entrepreneurship and Small Business Development, National Institute of Small Business Extension Training, and Small Industries Development Bank of India are the other agencies rendering assistance to women entrepreneurs.

Problems faced by Women Entrepreneurs

The problems faced by women entrepreneurs in India are immense and complex. They face more serious problems than men entrepreneurs. Some of these are:

- 1. No Independence:** Women in India lack the basic ingredients that are needed for a successful entrepreneur such as independence and authority. They are considered subordinate to men in all walks of life.
- 2. Low rate of Literacy:** Low literacy levels hinder women in carrying out their activities as entrepreneurs. Lack of education is a handicap in their understanding of technological and marketing issues.
- 3. Social Attitude:** Overbearing presence of elders restricts young girls from venturing out and very strict boundaries are drawn around their mobility, keeping women away from training and acquiring skills in rural areas.
- 4. Low Risk-bearing Capacity:** The psychological state of women does not allow them to bear high risks, which is a crucial factor and unavoidable in running an enterprise.
- 5. Financial Constraints:** Finance in an enterprise that is run by women still remains a challenge, because of their inability to provide tangible security. Very few women have property in their name. Banks also take a negative attitude while providing finance to women entrepreneurs. As a result they rely on their own funds and loans from family and friends, which is not sufficient to manage the enterprise.
- 6. Multiple Responsibilities:** A woman has to perform her responsibilities towards her family, organization and society. Consequently a serious conflict

emerges between home and work, resulting in high stress levels that inhibit her success, independence and progress.

7. **Marketing Problems:** Marketing is a serious problem encountered by women entrepreneurs because of intense competition, lack of storage facilities, and failure to synchronize their products with market requirements.
8. **Limited Mobility:** Women entrepreneurs are often hindered by their inability to travel from one place to another for business reasons. Further, the humiliating attitude of government officials, such as licensing authorities, labour officers, sales tax officials, etc. makes life miserable for women and forces them to leave the business in certain cases.

Self Employment of Women Association

Self Employed Women's Association (SEWA) is a trade union registered in 1972. It is an organisation of poor, self-employed women workers. These are women who earn a living through their own labour or small businesses. They do not obtain regular salaried employment with welfare benefits like workers in the organised sector. They are the unprotected labour force of our country. Constituting 93% of the labour force, these are workers of the unorganised sector. Of the female labour force in India, more than 94% are in the unorganised sector. However their work is not counted and hence remains invisible. In fact, women workers themselves remain uncared, undercared and invisible.

SEWA's main goals are to organise women workers for full employment. Full employment means employment whereby workers obtain work security, income security, food security and social security (at least health care, child care and shelter). SEWA organises women to ensure that every family obtains full employment. By self-reliance it is meant that women should be autonomous and self-reliant, individually and collectively, both economically and in terms of their decision-making ability.

SEWA organises workers to achieve their goals of full employment and self-reliance through the strategy of struggle and development. The struggle is against the many constraints and limitations imposed on them by society and the economy, while development activities strengthen women's bargaining power and offer them new alternatives. Practically, the strategy is carried out through the joint action of union and cooperatives. Gandhian thinking is the guiding force for SEWAs poor, self-employed members in organising for social change. They follow the principles of satya (truth), ahimsa (non-violence), sarvadharm (integrating all faiths, all people) and khadi (propagation of local employment and self-reliance).

SEWA is both an organisation and a movement. The SEWA movement is enhanced by its being a sangam or confluence of three movements: the labour

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movement, the cooperative movement and the women's movement. But it is also a movement of self-employed workers: their own, home-grown movement with women as the leaders. Through their own movement women become strong and visible. Their tremendous economic and social contributions become recognised. With globalization, liberalization and other economic changes, there are both new opportunities as well as threats to some traditional areas of employment.

1.6.1 Development of Rural Entrepreneurs

Rural entrepreneurship refers to the type of entrepreneurship based out of rural areas. As you are well aware, around 65 per cent of the Indian population resides in rural areas and therefore they represent more than half of the country's population. For the development of any nation, it is important that its population is empowered and one of the best ways to do is that is through employment. Entrepreneurship takes this initiative one step forward by bringing the freedom of decision making and innovation into the mix.

Rural entrepreneurship can be of many types including individual entrepreneurship, group entrepreneurship, cluster and cooperative entrepreneurship. Rural industries associated with rural entrepreneurship are of varied types including agro-industries, forest based industries, mineral based, handcraft, textile, services, etc.

The development of rural entrepreneurship is important because:

- It helps in the reduction of poverty and unemployment.
- It helps improve the standards of living.
- It promotes self-reliance.
- It helps keep a tab on migration.
- It is useful in better distribution of wealth and resources.
- It helps in minimizing regional imbalances.
- It assists in promoting decentralized industrial development.

Development of rural entrepreneurship requires:

- Smooth channels and availability of finance and credit.
- Strengthening of raw material availability.
- Better infrastructural support.
- Increased levels of education and training.
- Access to important and relevant information.
- Strengthening of non-governmental agencies.

There are many government schemes running for the promotion of rural entrepreneurship:

- Aspire - A Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship: It was launched to set up a network of technology centres

and to set up incubation centres to accelerate entrepreneurship and also to promote startups for innovation in agro industry.

- Credit Guarantee Scheme for Micro and Small Enterprises (CGTMSE)
- Prime Minister's Employment Generation Programme (PMEGP)
- Scheme of Fund for Regeneration of Traditional Industries (SFURTI)
- Swarojgar Credit Card
- Start-Up Village Entrepreneurship Programme (SVEP) which focusses on providing self-employment opportunities with financial assistance and training in business management and soft skills while creating local community cadres for promotion of enterprises.

*Concept of
Entrepreneurship*

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Check Your Progress

11. Name the scheme run by the State Bank of India to provide training and concessions to women entrepreneurs.
12. State any two problems faced by women entrepreneurs in India.
13. When was SEWA founded?

1.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Entrepreneurship transforms ideas into economic opportunities. This is the crux of entrepreneurship.
2. Innovation is one of the most important characteristics of entrepreneurship as it helps separate a good entrepreneur from a bad one.
3. An entrepreneur as a decision maker fulfills the following responsibilities:
 - Determining the objective of business enterprises
 - Procuring of new equipment and infrastructure
 - Introducing advanced technology to improve the quality of product
 - Developing market for the product
4. Entrepreneurs with the personality types of an Advisor are generous, demonstrative, people-pleasing and possessive. They are very sensitive to the needs of others and believe that the customer is king and will do everything possible to please their customers.
5. The negative trait of Challengers is that they want to work on their own and don't like to share leadership.
6. Successful entrepreneur should be disciplined, confident, open minded, competitive, creative, determined and passionate. He should also have good communication skills and strong work ethics.

*Self-Instructional
Material*

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7. Entrepreneurs should have strong communication skills as it not only helps them convey the right message but also motivates employees and creates a positive atmosphere conducive to the overall growth of the business.
8. For EdP, potential entrepreneurs are selected on the basis of their theoretical background and standard tests administered by experts. Several institutions of repute administer scientific tests such as Thematic Appreciation Test, Entrepreneurial Test, etc., which are followed by personal interviews. Besides, certain socio personal characteristics such as family background, age, size and type of family, education, and previous experience in trade are also be taken into consideration for selecting the potential entrepreneurs.
9. The ultimate objective of the EDP is to make the participants ready to start their industries.
10. The duration of EDP training is four weeks, and consists of six modules.
11. Stree Shakti Package is a scheme run by State Bank of India to provide concessions on loan along with low floating rate of interest.
12. The problems faced by women entrepreneurs in India are as follows:
 - No Independence: Women in India lack the basic ingredients that are needed for a successful entrepreneur such as independence and authority. They are considered subordinate to men in all walks of life.
 - Low rate of Literacy: Low literacy levels hinder women in carrying out their activities as entrepreneurs. Lack of education is a handicap in their understanding of technological and marketing issues.
13. SEWA was founded in 1972.

1.8 SUMMARY

- The term 'entrepreneur' is often used interchangeably with 'entrepreneurship'. But conceptually they are different. An entrepreneur is an individual, whereas the activities for starting up the enterprise are collectively referred to as entrepreneurship.
- Entrepreneurship transforms ideas into economic opportunities. That is the crux of entrepreneurship.
- Entrepreneurship involves decision-making, risk taking, skillful management, innovation and various other skills.
- In setting up an enterprise, an entrepreneur has to get involved in multiple tasks and multiple things, right from identifying entrepreneurial opportunity to organising resources to overseeing all business functioning.
- An entrepreneur recognizes an opportunity, gives shapes to ideas, assesses potential, consolidates resources, sets up an enterprise and then oversees it.

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- Every entrepreneur is not blessed with the same abilities and the personality type of entrepreneurs has been placed in nine types. These nine key personality types are based on the popular Enneagram's structure (the 9-point circle) which has been used to understand, analyse and influence the strategies of behaviour of individuals, organisations and cultures.
- The nine personality types of entrepreneurs are Improver, Advisor, Performer, Artist, Visionary, Analyst, Fireball, Challenger, and Healer.
- Entrepreneurship is not just about starting a business or making profit out of it. It is about having a corporate mindset, and adopting an approach and character that brings diversity to the field of business. Entrepreneurs are disciplined, goal-oriented, confident, open-minded, self-starters.
- Successful entrepreneur should be disciplined, confident, open minded, competitive, creative, determined and passionate. He should also have good communication skills and strong work ethics.
- The process of EDP involves the following sequence:
 1. Identification of prospective and right candidates
 2. Training and developing their entrepreneurial capabilities
 3. Linking suitable projects with each entrepreneur
 4. Equipping them with basic administrative, financial and managerial capabilities
 5. Providing follow up support in establishing the venture
- An EDP consists of three phases:
 1. Pre- training phase
 2. Training phase
 3. Post training phase
- The Pre-training Phase is intended to carry out the preparations required to launch a programme. The identification and selection of potential entrepreneurs is the most important aspect of pre-training phase. The selection procedure to be adopted should be based on sound theoretical background and standard tests administered by experts.
- In the training phase, the programme is launched in order to carry out necessary changes in the skills, attitudes and behaviour of the participants. Motivational inputs such as psychological games, tests, goal setting exercises and role play are used for this purpose.
- During the Post training phase, a review is done of the knowledge and skills acquired during the training phase. Follow up is essential for the success of any EDP.
- The EDP training is set up according to the training needs of participants, who are both existing and potential entrepreneurs, and industrial prospects

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of the area. The duration of the training programme is four weeks, and consists of six modules. The training method is a combination of group dynamics, lecture discussions, case studies, actual preparation of project assignment, and workshop exercise.

- Women entrepreneurship is a relatively recent phenomenon which came into prominence in the late 1970s. Favourable government policies towards the development of women, enhanced ratio of educated women, entrepreneurship awareness, and new opportunities are the reasons why more and more women are venturing as entrepreneurs in all kinds of businesses, economic and other useful activities.
- A number of institutions and agencies have been set up to develop entrepreneurship in women in India for purposes of training and giving financial and marketing assistance. Public sector banks and state financial corporations provide loans to women entrepreneurs. Schemes such as Self-employment for Educated Unemployed Youth and Mahila Gramodyog are implemented to develop women entrepreneurs.
- The problems faced by women entrepreneurs in India are immense and complex. They face more serious problems than men entrepreneurs. Some of these are lack of independence, low rate of literacy, financial constraints, marketing issues and limited mobility.
- Self Employed Women's Association (SEWA) is a trade union registered in 1972. It is an organisation of poor, self-employed women workers. These are women who earn a living through their own labour or small businesses. They do not obtain regular salaried employment with welfare benefits like workers in the organised sector.
- SEWA's main goals are to organise women workers for full employment. Full employment means employment whereby workers obtain work security, income security, food security and social security (at least health care, child care and shelter).

1.9 KEY WORDS

- **Entrepreneur:** It is a person who organizes, operates and assumes the risk for business ventures.
- **Innovation:** It is the process of developing new or better products, more efficient processes, or enhanced business models in order to improve the business.
- **Ethics:** It is concerned with rules of conduct that identifies right and wrong behaviour.

1.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What do you mean by entrepreneurship?
2. What are the nine personality types of an entrepreneur?
3. What are the important activities carried out in the Pre-training phase of EDP?
4. Write a short note on the course structure of an EDP.
5. What are the three categories into which women entrepreneurs can be classified?
6. What are the main goals of SEWA?

Long-Answer Questions

1. Examine the characteristics required to become a successful entrepreneur.
2. Explain the important functions of an entrepreneur.
3. Discuss in detail the qualities of a successful entrepreneur.
4. Analyse the importance of the three phases of the EDP.
5. Discuss the various measures taken to provide support and assistance to women entrepreneurs in India.

1.11 FURTHER READINGS

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UNIT 2 FACTORS INFLUENCING ENTREPRENEURSHIP

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Structure

- 2.0 Introduction
- 2.1 Objectives
- 2.2 Internal and External Factors
- 2.3 Institutional Finance to Entrepreneurs
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2.0 INTRODUCTION

The success of an entrepreneur is influenced by different factors. These factors can be both internal and external. While the internal factors are related to the entrepreneur's personal information, the external factor can be based on the availability of resources and the government's policy. Another important aspect of entrepreneurship is the financing. Finance is needed to fulfill short-term as well as long-term requirements of a project. This unit will discuss in detail the different means of obtaining finance. The role of various support agencies will also be examined.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe the internal and external factors influencing entrepreneurship
- Discuss the importance of finance appraisal and the different options available to an entrepreneur

- Explain the role and functions of DICs, NSIC, SIDO, SISIs, NAYE, TCOs, KVIC and IFCI

2.2 INTERNAL AND EXTERNAL FACTORS

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There are two types of factors that motivate an entrepreneur:

1. Internal factors
2. External factors

Internal Factors

These are unique factors and differ from person to person. Internal factors refer to a person's family background, his level of education and his desire to achieve. The following are examples of internal factors:

1. Desire to do something new
2. Level of education
3. Technical education or technical background
4. Number of years of experience
5. Occupational knowledge and background

External Factors

These are common to every individual and are outside the scope of any one individual. These factors are based on the availability of resources, government's policies towards industrialization and policy makers' vision. The following are examples of external factors:

1. Government support and assistance towards industrialization
2. Availability of factors of production (land, labour, capital) and the present economic condition of the country
3. Interest and support from established business houses
4. Hopeful demand for production

Check Your Progress

1. Give some examples of internal factors that influence an entrepreneur.
2. What are external factors of entrepreneurship dependent on?

2.3 INSTITUTIONAL FINANCE TO ENTREPRENEURS

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Finance is the lubricant in the operations of a project. After completing a favourable feasibility study, the entrepreneur should identify the sources of finance so as to meet start up expenses such as licensing fee, documentation fee on loans, site registration and stamp duty charges, site development cost, power connection, and water supply charges. Finance is required to meet both long term as well as short term requirements of the project.

Short-term financial requirements

Short term finance is needed to meet the day-to-day operations of a project or to supply working capital to a project. Short-term finance requirements are:

1. Procurement/purchase of raw material,
2. Payment of salaries and wages
3. Meeting power and fuel expenses,
4. Remitting rent, interest, commission, insurance premium,
5. Meeting the stationery and bank charges, and
6. Purchasing small tools and meet other day-to-day expenses of the project.

Long-term financial requirements

Long term need for finance is based on the size of operations. It is for acquisition of fixed assets such as:

1. Site/land purchase and development,
2. Construction of plant and buildings and development of infrastructure,
3. Purchase of machinery, equipment, tools, furniture and fittings, and
4. Purchase of moveable property such as trucks, vans, cars, lorries and other vehicles.

Overall need for finance is to meet the fixed and variable costs of the production process, purchase fixed assets and for payment of interest on debt, and other working capital needs of project.

There was a time when project finance was a fairly simple banking exercise. However, many changes in the economic environment have taken place and the process is no longer simple. The figures for total investment in almost any major capital plant development have, by the joint action of inflation and technical innovation, reached huge dimensions which an individual company cannot accommodate. Again high rates of inflation have escalated costs, particularly in relation to the basic price of any capital plant where a

long period of manufacture is required before it can be set up and start functioning.

Financial appraisal is probably the most important aspect of project financing. It covers the following aspects:

- i. The total capital cost of the project
- ii. The means of finance to meet the projected cost
- iii. The projected operating costs and revenues.

Finance is a constant problem, and if small-scale industries are to develop according to Government policy, they must have adequate credit. Credit is available on the basis of the creditworthiness of the entrepreneur. In regard to capital structure and working capital management, there are many differences between large, medium and small-scale industries. Finance is the life-blood of any business. Its management is an art and merits special attention. The financial function of management is to:

- (a) Ensure fair return on investment;
- (b) Generate and build surplus and reserves for growth and expansion;
- (c) Plan, direct and control the utilization of finances so as to ensure maximum efficiency of operations and build a proper relationship with suppliers, financiers, workers and members; and
- (d) Coordinate operations of the various departments through appropriate measures to ensure discipline in the use of financial resources.

Types of finance

There are various needs for finance in a project. Finding the means of obtaining finance to satisfy a particular need requires an understanding of the project operations and different activities of that project and its span of time and size. Project activities are generally sequential; which means that on completion of one activity the other begins. Sometimes two or more activities can also be done simultaneously. What type of finance is suitable for a project activity and how many types of finance should be tapped demands a continuous review of the project performance. The following are some important forms of finance.

• Overdraft

This is one of the facilities provided by the banker on the current account. Under this, an account holder can draw some amount (to the extent of his overdraft limit) from his current account without credit balance. Based on credit worthiness, an overdraft limit is sanctioned to the current account holder. It is a popular form of finance because it has the advantages of availability, convenience and flexibility. However, because interest rates are high, it should only be used for short-term requirements such as funding working capital.

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- **Bank term loans**

These loans are intended to meet the needs of financing fixed assets. These provide fixed-term finance for longer periods. They are often secured by a charge against company assets and require the entrepreneur to sign legally binding covenants. The entrepreneur needs these types of loans to meet his company's long term business requirements such as for constructing buildings, plant and purchasing machinery and for infrastructure development.

- **Asset-based finance**

This is generally used for purchasing capital goods, which require a huge amount of money. The asset is essential for business operations and will provide profitability to the project for a long period of time. Asset-based finance describes financing as an asset over its estimated life span using the asset as security for the loan. It can be structured so that the borrower has the sole right to use the asset and ownership transfers to the borrower at the end of the loan period.

- **Receivables finance**

This form of finance is meant for meeting the short-term financial needs of merchandize against credit sales or services. The credit merchandizer provides goods or services to a customer and invoices them, and sends the same to the banker. He has access to reserve funds up to an agreed percentage of the invoice value. He can withdraw the amount from his account as and when needed. Either the banker or an overseas representative will collect the sales proceeds from his customer. When the invoice is paid, he receives the balance. In the case of undisputed receivables where a customer defaults or becomes insolvent, if the merchandizer has taken out credit protection on the customer with his banker, the banker will pay him the outstanding balance up to the value of the agreed credit protection limit. This form of finance uses outstanding customer invoices as security.

- **Invoice discounting**

Similar to Receivables Finance, this is usually only offered to larger companies with strong credit management systems.

- **Angel funding**

An angel investor is a financially sound or wealthy individual who can provide capital for starting a business, generally in return for ownership equity or convertible debt. Although still not too many, a growing number of angel investors are organizing themselves into angel networks or groups for sharing research and pooling their investment capital. Unlike venture capitalists who professionally manage money

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pooled from others, angel investors usually invest their own resources. Though they usually reflect the individual's investment judgement, the actual entity providing the funds could be an investment fund, a limited liability company, a business or a trust. The capital obtained from angel investors is meant for filling the gap in start-up financing between 'family and friends' who offer venture capital as well as seed funding. Simply put, angel funding refers to an individual investing in a company in return for shares in the company.

• **Venture capital**

This deals with financial investment in highly risky propositions, in the expectation that high rates of return will be earned. It is generally considered a synonym for high risk capital. Capital is provided by venture capital funds which are prepared to finance an untried company that appears to have promising prospects. Venture capital is a solution for capital mobilization of small scale industries, which are unable to tap the capital market for their capital requirements. A team of individuals pool their finances for providing capital funds to a new business that is just commencing. They invest in them in the hope that these businesses will develop and earn profits.

• **Conventional loan**

A conventional loan is typically any kind of lender agreement. There are several broad categories of conventional loans. Fixed rate mortgages are simpler in some cases. A home borrower 'locks in' at an interest rate, and he or she pays down the principal and interest on the mortgage every month at that rate. Other so-called conventional loans include conforming loans. Conventional loans are available either as long term or short term loans. For example, it is possible to repay personal loans over a longer duration. The characteristic of conventional loans is that they are set at a fixed interest rate.

• **Personal lease**

Personal lease means a vehicle that may be taken on a rental basis for a pre-decided period of time (generally one to five years) and monthly repayments may be made just as in renting a house. The difference between personal lease and rent is that in the case of a personal lease, at the conclusion of the pre-decided rental period, it becomes possible to sell the vehicle, or it is taken back by the financial company that rented it, and then sold as a used vehicle. Generally, people use a personal lease when they require a vehicle for household or private purposes over 50 per cent of the time. In case they also use the vehicle for business purposes, some tax deductions may be available against the personal lease.

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• Hire purchase

This is another type of finance generally used by entrepreneurs for acquiring assets. Most small businesses opt for hire purchase because of the flexibility it offers in getting the required machinery and vehicles. For example, in a hire purchase agreement, an entrepreneur is obliged to purchase the vehicle through a final payment (balloon payment) made at the conclusion of the pre-decided hire purchase period, in addition to the installments that he pays during the lease period. In the hire purchase option, the contract can be arranged by the entrepreneur in such a way that the monthly installments suit budget and cash flow of the business – by enlarging the size of the balloon payment or deposit, the size of the monthly installments can be reduced. Flexibility in repayment in a hire purchase contract is attractive for a business that is just commencing and has numerous demands on its cash flow. It may enjoy some tax deductions for interest charges and depreciation in hire purchase contracts.

• Operating lease

In this agreement, the financial provider keeps the ownership rights of the vehicle and allows the customer to utilize it exclusively for one to five years against lease rental payments – similar to a long-term hire vehicle. For an entrepreneur who is keen to frequently change around his vehicles, after using them to the maximum, lease agreement is the best option. The advantage of operating lease is that the user of the vehicle need not have any worries regarding the residual value at the conclusion of the lease period and it is the financial service provider who stands to lose money on the vehicle's resale. In the case of operating leases, the vehicles that the company uses do not show up in the assets side of the balance sheet as assets. Hence, the gearing levels are not affected by the vehicle borrowing costs. Another advantage of operating leases is that, excepting except in the case of luxury vehicles, lease payments are entirely tax-deductible.

Chattel mortgage

This financing option is suitable for a business that accounts for its operations on a cash basis. Its functioning is similar to hire purchase agreements: series of monthly payments are made by customers, followed by a balloon payment. A high degree of flexibility is also offered by chattel mortgage, as the duration of the lease payment can be set by the buyers along with adjusting the monthly repayments by enlarging or diminishing the size of the balloon payment or deposit amount.

Other options

The last few years have witnessed an expansion in the products offered by financing companies. Products such as credit cards, fuel cards, maintenance, fleet management and insurance are also offered by various financing companies.

Check Your Progress

3. State the three important aspects covered by finance appraisal.
4. What is asset-based finance used for?
5. What is the difference between venture capitalists and angel investors?

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2.4 FUNCTIONS OF SUPPORT AGENCIES

The Government of India as well as State Governments have launched various support agencies such as DIC, SIDBI, SIDCO, SSIB, NSIC and SISI. Let us examine the role of these support agencies.

2.4.1 District Industries Centres (DICs)

The Industrial Policy Resolution of 1977 proposed the setting up of a District Industries Centre in each district headquarters of India. Based on the recommendations, the District Industries Centre was established in 1978 and it became a landmark in the development of small and cottage industries in India. The main objective of the DIC was to provide all the services and support required by small and cottage entrepreneurs under a single roof. It means that the entrepreneurs who previously had to go to different agencies for assistance/guidance, finance, training, technical advice, would now be provided with all these services in one place.

Structure of DICs

The DIC structure consists of:

- A General Manager
- Four Functional Managers:
 - i. Economic and Investigation
 - ii. Credit
 - iii. Village Industries
 - iv. Raw material/Marketing/Training
- Three Project Managers (to provide technical services in the area relevant to the needs of the districts concerned).

The structure is the same in all the DICs in our country. DICs coordinate with all the central and state government organizations concerned with promoting and developing cottage, village and small scale industries and provide prominent services to entrepreneurs.

Functions of District Industries Centre

The DIC performs the following functions to promote and develop village, cottage and small scale industries in the concerned district:

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1. **Conducting motivation campaigns:** From time to time, DIC conducts motivation campaigns throughout the district to identify and motivate the aspirant entrepreneurs. The DIC takes steps to design a programme to cover all the government schemes and inform them of the criteria for application.
2. **Industrial surveys:** This is one of the important functions of DIC. It conducts industrial surveys to assess industrial potential in the district keeping in view the availability of raw materials, human skills, infrastructure, supply and demand, etc. DIC prepares techno-economic studies, to find out the technological and economical feasibility of a project/services and works out cost estimates to launch the product or services. On the basis of studies and estimates of investigation it provides investment advice to entrepreneurs.
3. **Achievement plans:** DIC is concerned about the development of industries in districts. Hence after conducting motivational campaigns and industrial surveys, it prepares achievement plans. These plans are coordinated with the District Credit Plans of the lead bank. A lead bank is a bank which is identified by the government in the concerned district based on various aspects.
4. **Industry registration:** DIC provides provisional and permanent registration to new entrepreneurs.

Provisional registration: Provisional registration is given to an entrepreneur to take all necessary steps to bring the unit into existence. It is awarded for a period of two years in the first instance and can be renewed every year thereafter. But renewal cannot be done more than twice. Provisional registration enables entrepreneurs to:

- Apply local authorities such as corporation, municipality and gram panchayats to construct building for establishing the unit.
- Apply for plot/shed (location) in industrial estate.
- Apply for minimum amenities such as power and telephone connection.
- Apply to financial institutions/banks to get financial aid.
- Apply for State Sales and Central Sales Tax Registration.
- Apply to NSIC and other institutions to buy machines.

Permanent registration: Once the installation work is over, the entrepreneur may apply for permanent registration. On getting the permanent registration, the entrepreneur is entitled to get the following facilities:

- He can apply for scarce raw material on concessional rates from government sources
- He can apply for marketing his products through government agencies

However, registration of a new unit is not compulsory. But registration will help the entrepreneur to avail certain facilities which are not otherwise provided.

5. **Assist in obtaining credit:** Being an entrepreneurial support agency, DIC recommends loan applications to banks and financial institutions and assists in obtaining credit. DIC liaisons with banks and financial institutions in favour of industries and monitors flow of credit to industries in the district.
6. **Provide guidance and assistance:** DIC provides guidance and assistance to entrepreneurs in identifying appropriate machinery and equipment, and finds sources of supply for machinery and also importing machinery. It also ascertains raw material requirements and their sources, arranges bulk purchase of raw materials and interacts with various authorities for the supply of scarce and critical raw material.
7. **Recommending applications:** DIC recommends applications of entrepreneurs to various organizations. For example, dealing with Electricity Board to get power connection, power tariff concessions and subsidies.
8. **Organize fairs and exhibitions:** DIC encourages the small scale industry units to participate in International Trade Fairs by providing free space for displaying their products. It helps entrepreneurs become quality conscious and to grab the opportunity to export their products.
9. **Help in marketing products:** DIC from time to time collects marketing information and organizes marketing outlets, keeps liaison with government procurement agencies, assesses the possibilities of export and ancillarisation and suggests appropriate marketing strategies to entrepreneurs.
10. **Organize training:** To enrich the entrepreneurs' skill and knowledge, DIC conducts training programmes for artisans and identifies opportunities and project for the trainees.
11. **Entrepreneur Development Programme (EDP):** To provide knowledge and to increase the skills of entrepreneurs in different areas of operations, DIC conducts EDPs in association with various organizations.

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2.4.2 Small Industries Development Organisation (SIDO)

The Office of Development Commissioner, Small-scale Industries (DC-SSI), is also called the Small Industries Development Organization (SIDO). The office of the Development Commissioner Small Scale Industries (DC -SSI) is directly under the Union Ministry of Micro, Small and Medium Enterprises and is a nodal agency formulating, coordinating and monitoring the policies and programmes for the promotion and development of small-scale industries in the country.

SIDO functions as the nodal development agency for small and micro industries. SIDO was established at the same time as the SSI Board, on the recommendations of the Ford Foundation. In the past few years it has transformed into an agency for developing the small industries sector in all manners possible.

There are a number of support services provided by SIDO and its associate institutions. In addition, SIDO operates a number of schemes for the SSI sector. Some representative activities are as follows:

- *National awards:* SIDO has instituted three national awards for outstanding SSI entrepreneurs. In addition, there are special awards to recognize excellence at the state level. These have been in existence since 1983. Manufacturers of quality products of consumer interest in fifteen select groups of industries (in the SSI sector) are provided quality awards. There are two special national categories - women entrepreneurs and SC/ST entrepreneurs that are awarded every year. The objectives of the awards are to encourage small entrepreneurs to innovate, upgrade quality, expand market, and modernize.
- *Integrated Infrastructure Development (IID) for state governments and for infrastructure development by industry associations:* Up to 40 per cent assistance is provided for setting up industrial estates for SSI units for state governments. For the North Eastern states, the assistance is more generous. In addition, there is assistance of up to 90 per cent in setting up new mini tool rooms and for upgradation of existing tool rooms. This assistance covers 75 per cent of the costs. The percentage is subject to limits.
- *Schemes to provide assistance of up to 50 per cent for setting up:* Testing centers have been formulated for industry associations. Associations can avail a one-time grant for procurement of hardware and thereafter there is a matching grant on tapering basis for running expenses, which is available.
- *Entrepreneurship development and management training:* The National Institute for Entrepreneurship and Small Business Development

(NIESBUD) and the National Institute of Small Industry Extension and Training (NISIET), which are under the administrative control of SIDO organize various Entrepreneurship Development Programmes (EDPs) and devise training aids and materials for regular training. In addition, special courses are organized for targeted groups of entrepreneurs. Supplementing these efforts, MSME Development Institutes/ Branch institutes, under the guidance of SIDO, offer a variety of management training programmes.

These programmes are aimed at identifying entrepreneurial capabilities. They focus on motivating and training entrepreneurs with skills that enable them to set up and run industrial units successfully.

- *Collection of statistical data:* SIDO updates its database, under a scheme entitled 'Collection of the status on SSI units'. It organizes sample surveys, industrial censuses, field studies, on SSIs. SIDO supplies monthly statistics on the production of select items. The data is used to develop the Index of Industrial Production (IIP). The IIP is published by the Central Statistical Organization. In addition, SIDO has brought out a number of publications and prepared a number of reports covering different types of information on various facets of the SSI sector from the data it collects.
- *Preparation of project profiles:* SIDO collects information on markets and technology, which is collected and assessed. Based on this information, it prepares project profiles on various product groups annually. Project profiles contain detailed information on the product manufacturing process, market potential, quality control and standards, investment requirements, sources of raw material and machinery suppliers, profitability, and so on. These are disseminated to small and medium entrepreneurs. SIDO prepares and updates about 1,000 project profiles for different products annually. These profiles are often supplemented by industrial potential/feasibility reports. Industry group coverage provides additional direction to entrepreneurs, especially when supplemented by product-wise profiles.
- *Credit guarantee scheme:* Collateral-free loans are disbursed and limits are specified from time to time. The existing limit is ₹ 2.5 million.
- *Plant modernization studies:* Programmes for modernization, for small-scale units located in dense industry clusters, are carried out by undertaking detailed in-plant studies. These studies identify the present use of process/technology and advise how the units can upgrade their existing technology. In addition, SIDO has a credit linked capital subsidy scheme for technology upgradation for individual SSIs. There is a capital

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subsidy at 12 per cent on loans taken for technological upgradation. This is subject to limits announced from time to time.

- *Quality Certification Reimbursement Scheme:* Incentive schemes have been formulated for quality improvement in working towards Quality Management System (QMS) ISO 9000 certification and Environment Management (EMS) ISO 14001 certifications. Reimbursement of expenses to the extent of 75 per cent is provided for.
- *Marketing Support for individual SSIs/ Ancillary/ Tiny/ SSSBE units:* Preference in Central Government purchases for individual SSIs, is provided by SIDO. Under this scheme, the Central Government has reserved a number of items, which are for exclusive purchase from SSI units only. Facilities provided to units for Government purchases not covered in the category identified here, include free of cost tender documents, exemption from earnest money and security deposit, and 15 per cent price preference on Central Government purchases. This is administered through the Single Point Registration Scheme of NSIC.

Another SIDO marketing promotional scheme involves promoting participation of SSIs in domestic and international trade fairs. SIDO provides marketing assistance for individual SSIs and associations under a scheme which offers funding upto 90 per cent in respect of to and fro airfare for participation by SSI entrepreneurs in overseas fairs/trade delegations and full subsidy on space rent and shipment of exhibits of SSI units for individual SSIs. The scheme also provides for funding for producing publicity material (upto 25 per cent of costs), sector-specific studies, and for contesting anti-dumping cases.

In addition, packaging is critical not only for marketing, but also for preservation of goods. This is a weak area of SSIs and SIDO imparts training in packaging technology, with programmes instituted with the specific objective of improving packaging standards.

- *Employment guarantee schemes:* SIDO has been operating rural employment generation schemes, which include the Prime Minister's Rozgar Yojana (PMRY) and Rural Employment Generation Programme (REGP). PMRY aims at providing employment to more than 1 million people through the setting up of 0.7 million micro enterprises by (unemployed) educated youths. The scheme also seeks to associate reputed NGOs in its implementation throughout the country. The Self-Employment Scheme for the Educated Unemployed Youth (SEEUY) was to promote the setting up of business ventures in industry and

services. SEEUY was later merged with PMRY. Rural Employment Generation Programme (REGP) consists of a number of self-employment programmes for the rural poor which were merged into a single programme called the ‘Swaran Jayanti Gram Swa-Rozgar Yojana’.

These schemes are now been merged into a new scheme, which is known as the Prime Minister’s Employment Generation Programme (PMEGP). Under this scheme, the Government will set up 1.7 million entrepreneurial projects generating 10 million job opportunities during the eleventh plan against the combined PMRY and REGP target of 4.4 million jobs under the ongoing tenth plan. Out of these, 7 million jobs are proposed for SC, ST, OBC, minorities and the North-East states.

SIDO has over 60 offices and 21 autonomous bodies under its management. SIDO provides a comprehensive range of facilities for formulating, coordinating, and monitoring the small scale and micro enterprises sectors. The SIDO network, at present, consists of the following:

- 28 MSME Development Institutes (MSMEDIs) formerly known as Small Industries Service Institutes (MSMEDIs),
- 30 Branch MSME Development Institutes (Br. MSMEDIs) formerly known as Branch Small Industries Service Institutes (Br. MSMEDIS),
- 4 Regional Testing Centers (RTCS),
- 7 Field Testing Stations (FTSS),
- 19 autonomous bodies which include 10 Tool Rooms (TRs) and Tool Design Institutes (TDI),
- 4 MSME Technology Development Centers (MSMETDCs),
- 2 Central Footwear Training Institutes (CFTIS),
- An Electronics Service and Training Centre (ESTC),
- An Institute for Design of Electrical Measuring Instruments (IDEMI),
- 2 national level training institutes, and
- A departmental training institute and a production centre.

2.4.3 Small Industries Service Institutes (SISIs)

SISIs were set up by the Government of India to provide consultancy in the areas of project plan preparation and execution and training to small entrepreneurs. There are 28 SISIs working across the country. These are non known as MSME-DI (Development Institutes). There are close to 30 MSME-DIs in the country as of 2018. The major functions of SISI are:

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Technology adoption advisory service:

- Providing advice for required suitable technology in setting up of new small scale units, assisting in the design of choice of machinery, layout, installation and operation of plant and machinery.
- Assisting in preparation of design and drawings for production equipment and accessories to improve production process.
- Providing technical guidance on the proficient use of raw materials, utilization of substitutes, waste and scrap.
- Providing technical assistance and guidance in design and development of new products.

Workshop and Laboratory Services: Every SISI has its own workshop, laboratory and showroom. The intention of having these is to provide on the job training both in theory and practice to small entrepreneurs in a systematic way so as to strengthen their knowledge and skills. With these facilities, SISI provides the following services:

- Common service and tool room facilities
 - Experiments and laboratory analysis on new and substitute raw materials
 - Assistance in testing raw materials and new products before their release into the market
1. **Consultancy Services on Functional Management:** SISI has adequate capabilities to provide guidance on functional management services by suggesting proper methods of industrial management, including cost reduction, production management, marketing of products, human resource planning and development, etc.
 2. **Training Services:** SISI and the extension centres provide training services to the workers of small scale units in certain trades such as machine shop practice, tool and die making, welding, electroplating, wood working, assembling, fittings, etc. SISI and the extension centres provide not only training to workers but also to foremen of small scale units on ad hoc basis as well as on an organized basis.
 3. **Balanced Regional Development Services:** SISIs focus their activities on balanced regional development by promotion of entrepreneurship and development of small scale industry in rural and underdeveloped areas. SISIs develop entrepreneurship in backward regions by organizing training programmes for educating youth such as engineers, graduates, students, ex-servicemen etc. and especially people from backward, rural, tribal and hill areas.

4. **Economical Development Services:** SISIs are intended to provide economic services to small scale units. The various economic development services provided by SISIs are:

- Surveys of particular industries and areas and recommendations for development programmes
- Market surveys for industrial enterprises for optimum utilization of their time on production quality maintains
- Market information in selected areas for purpose of dissemination.

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2.4.4 State Industries Development Corporation (SIDCO)

The State Industries Development Corporations were set up in various states under the Companies Act, 1956 to provide the primary development needs of tiny, small, village and cottage industries. In Andhra Pradesh, the Small Industries Development Corporation Ltd (SIDCO) was set up in 1960 for promoting and developing small scale industries in the state.

SIDCO has been working actively since its inception and is engaged in the following:

1. **Industrial estates design and promotion:** SIDCO is constructing industrial work sheds with all infrastructural facilities such as roads, power and lights, water supply, drainage facilities etc. in selected locations. It also caters to the development of plots in various industrial estates. To meet the needs of rural artisans and unemployed youth SIDCO in Andhra Pradesh has constructed tiny sheds in various locations. SIDCO is counseling, aiding and assisting entrepreneurs to exploit the potential in a particular area.
2. **Cater marketing assistance:** On behalf of small scale units SIDCO participates in the tenders proposed by government departments and acquires orders for them. SIDCO has taken the initiative to organize the Buyer-Seller Meet so that the government department will be aware of the SSI products and also to give an opportunity to SSI units to know the actual demand of the departments. To serve SSI consistently, SIDCO participates in the Director General of Supplies and Disposal (DGS&D) tender on behalf of SSI units.
3. **Work as recognized export house:** The State Government has recognized SIDCO as an export house of the State. As a recognized export house SIDCO identifies potential industrial units supplying export-worthy products and prospective buyers abroad. SIDCO also makes contracts with overseas importers and their agents in India and assists SSI units in exporting their products. SIDCO also participates in International Trade Fairs and exhibits the products of SSI units.

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4. **Balanced regional development:** SIDCO has been working for industrial development in backward areas for the balanced regional development. In order to develop the backward areas industrially and to provide employment to rural educated unemployed youth SIDCO constructs industrial estates in rural areas. SIDCO also constructs separate industrial estates for women and for NRIs in various parts of the state.
5. **Hire purchase and equipment leasing scheme:** Under this scheme, SIDCO provides a package assistance of the allottees of sheds at industrial estates for the supply of machinery and equipment. Under this scheme, the machinery and equipment ownership rights are transferred to the allottee after he has paid the last installment.

2.4.5 National Small Industries Corporation (NSIC)

In 1955, to encourage the growth of small scale industry in different parts of the country, the Government of India set up the National Small Industries Corporation (NSIC). It is an ISO 9001:2000 certified company. NSIC operates through nine regional offices with the support of 21 branch offices and 26 sub offices for cluster development along with eight technical services and extension centres that have the backing of over 500 professionals scattered throughout the country. NSIC also operates from its offices in Dubai and Johannesburg to serve the regions of Gulf and Africa.

Since its inception, NSIC has been serving the small scale industry, mindful of the industrial resolution policies and government industrial development plans in various Five Year Plan programmes.

NSIC has demonstrated its strength within the country and abroad through the promotion of quality consciousness, the enhancement of exports of products and projects from small-scale enterprises, strengthening the linkages with medium and large scale enterprises, upgradation of technology and modernization of the production process and delivery. Newer opportunities and challenges for small and large businesses have been thrown up by the twenty-first century. With the world becoming an increasingly smaller and furiously competitive market place (not only physical but also a virtual market place), SSI activities too have become increasingly more challenging. It recognizes these challenges and to enable the small scale units to gain competence advantage and to contribute effectively to the development of economy, the corporation has restructured its activities for meeting the dual challenges of competition and growth in the small scale industries sector. A more focused sectoral approach has been adopted by it aimed at tangibly contributing to SSI growth and competence building.

The wide range of services provided by NSIC is basically promotional in nature. It means that NSIC services are focusing on getting the machinery and

equipment on hire purchase basis. The main functions of NSIC are described in the following sections.

Supply of machines on hire purchase basis

The NSIC supplies machines on hire purchase basis to small scale industries located in various parts of the country. Under this function NSIC takes upon itself the entire purchase procedure, starting from locating competent suppliers to delivery of machines. NSIC obtains clearance from Director General of Industries in case of imported machines, to arrange foreign exchange, obtains import license, opens letter of credit and looks after customs requirements and clearance of machines. NSIC not only supplies machinery for the new industrial establishment but also for replacement of outdated or obsolete machinery as well as balancing equipment to increase productivity. Through its equipment leasing scheme, Small Scale Industrial units can procure industrial equipment for modernization, expansion and diversification.

Other functions of NSIC

Some of the other functions of NSIC include the following:

- Procurement, supply and distribution of indigenous and imported raw materials
- The development of export-worthiness of small-scale units and encouraging the export of small scale industries' products
- Giving equal priority to the enlistment of competent units and facilitating their participation in Government
- Stores Purchase Programmes providing training in several technical trades
- Motivating small scale units on technological upgradation through Software Technology Park and Technology Transfer Centres
- Acting as mentor to small scale units and providing advisory services
- Setting up small-scale industries in developing countries on turnkey basis and other areas of services and international co-operation.

Marketing supply programme of NSIC

Marketing has become an essential entrepreneurial function. Small industries have to face challenges in marketing their services and goods and consequently, need institutional support. NSIC has formulated a number of programmes for SSIs in the marketing sector, both within and outside the country.

- (a) NSIC has been assisting those SSIs that are capable of manufacturing quality products, but are constrained by limited financial resources or lack of broad equity and credibility.

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- (b) NSIC has been acting as a nodal agency to SSIs for bringing them closer to the several governmental purchasing agencies.
- (c) The Government, along with its agencies, has been purchasing several kinds of services and products produced by SSIs

2.4.6 National Alliance of Young Entrepreneurs (NAYE)

The National Alliance of Young Entrepreneurs has made several schemes for entrepreneurs' development in collaboration with public sector banks such as Bank of India, Dena Bank, Punjab National Bank, Central Bank of India and Union Bank of India.

The objectives of the schemes are:

1. To help young entrepreneurs in identifying investment and self-employment opportunities.
2. To secure proper arrangement for their training.
3. To provide necessary financial assistance on the basis of project reports
4. To secure package of consultancy services.
5. To arrange assistance, facilities and incentives that are extended to entrepreneurs by the government and other institutions.

2.4.7 Khadi and Village Industries Commission (KVIC)

The KVIC is a statutory organization established in 1956 by an Act of Parliament. The main objectives of the KVIC include skill improvement, providing employment in rural areas and transfer of technology, rural industrialization and promoting self-reliance among the people and to build a strong rural community base.

KVIC has a wide portfolio of products covering 108 industry groups and over 4,000 products. KVIC's functions also comprise building up a reserve of raw materials, creation of common service facilities for processing of raw materials as semi-finished goods, and provision of facilities for marketing of KVIC products. In addition, KVIC has a setup to guide artisans through supply of designs, prototypes, and other technical information. It is also charged with the training of artisans engaged in these industries and the task of providing financial assistance to institutions or persons engaged in the development of khadi and other village industries.

KVIC operates through 30 State / UT Khadi and Village Industries Boards (KVIBs). KVIC has 7050 sales outlets, has its presence in three hundred thousand villages and employs 8.3 million people. Its annual sale in 2005-06 was approximately ₹ 150, 000 million making it the largest FMCG organization in the country, which was higher than Hindustan Unilever Limited's, ₹ 137, 000 million in 2007. As per their Annual Report 2017-18, sales of khadi was ₹ 2503 crore during the year. More than 375 new khadi institutions were added post 2015.

2.4.8 Technical Consultancy Organizations (TCOs)

TCOs have been conceived as service organizations for promotion of industrialization in the country. The prime objective of these organizations is to provide a package of services under one roof to entrepreneurs from the stage of project identification to successful implementation and working of the unit. This is called the Single Window Scheme.

The scope of the services of TCOs are organized on a regional basis, so as to overcome the disparities in various regions on the basis of natural resources and environmental conditions and in order to make technical services available according to the local demand and resource endowment. There are 18 TCOs in different states sponsored by IDBI, IFCI, ICICI and State Small Industries Corporations.

Services of TCOs

TCOs are providing services to new entrepreneurs and existing units. Based on their individual requirements, TCOs design their services.

Services to new entrepreneurs

- Assist in identification of profitable project opportunities
- Assist in preparation of project profiles, techno-economic feasibility studies
- Conduct market surveys and pre investment studies
- Provide help in identification and selection of plant/equipment

Services to existing enterprises

- Guide the entrepreneur in the area of modernization, expansion and diversification
- Assist in identifying problems of the unit and suggesting specific corrective measures
- Provide services in functional areas of enterprise such as management, technical and financial consultancy
- Review and monitor the project
- Provide studies on energy conservation and effluent treatment
- Assist mergers and reconstruction of the units

Common services to all entrepreneurs

- (a) **Entrepreneurship Development Programmes (EDP):** One of the important activities of TCOs is providing training to potential entrepreneurs through EDP. TCOs conduct EDPs for different target groups like technical entrepreneurs, women entrepreneurs, rural entrepreneurs, tribal entrepreneurs, etc.

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(b) Services to Sick Units: Providing services to sick units is essential in economic development, so as to reduce or prevent the blocked investment wastage and protect the employees' interests. TCOs are providing the following services:

- Diagnostic studies to assess the working of existing units and reason for sickness
- Rehabilitation plans for revival of sick units
- Technical, managerial and commercial counseling

2.4.9 Industrial and Technical Consultancy Organisation of Tamil Nadu Limited (ITCOT)

Industrial and Technical Consultancy Organisation of Tamil Nadu Limited (ITCOT), was incorporated as a company under the Companies Act, 1956, on 17 July 1979 as a joint venture of leading financial institutions, State Development Corporations, and Commercial Banks. The name of the company was changed to ITCOT Consultancy and Services Ltd. with effect from 4 October 2004 to offer services as an adjunct to consultancy. The company still continues to be known by its popular name of ITCOT.

Promoters

The promoters of ITCOT are:

All India Financial Institutions

- ICICI Bank Ltd.
- IFCI Ltd.
- SIDBI.

State Development Corporations

- State Industries Promotion Corporation of Tamil Nadu Ltd. (SIPCOT)
- Tamil Nadu Industrial Investment Corporation Ltd. (TIIC)
- Tamil Nadu Small Industries Development Corporation Ltd. (SIDCO)

Commercial Banks

- State Bank of India
- Indian Bank
- Indian Overseas Bank
- Canara Bank
- Central Bank of India

- Union Bank of India
- Syndicate Bank
- Bank of Baroda
- The Lakshmi Vilas Bank Ltd.
- The Karur Vysya Bank Ltd.

Services offered by ITCOT

Asset Planning

- Pre-Investment Studies
 - Escort Services
 - Project Appraisals
 - Support Studies

Asset Creation

- Detailed Engineering
- Project Management

Asset Restructuring

- Sick Unit Rehabilitation Studies
- Modernisation/Technology Upgradation Studies

Asset Management

- Asset Valuation
- NPA Recovery
- Receivership
- Custodianship

Energy and environment

1. Studies on Cogeneration and Biomass Gasifier
2. Studies on Biofuels
3. Energy Audits
4. Environment Impact Assessment (EIA) Studies
5. Solar Energy Studies
6. Wind Energy Studies
7. Studies on Sewage and Effluent Treatment & Waste Water Recycling

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8. Waste-to-Energy Studies
9. Training Programmes and Seminars

Rural Industries Programme

- Project Identification & Project Reports
- Training
- Technology Linkages
- Market Linkages
- Credit Linkages
- Other Services

Education

ITCOT offers educational programmes in logistics and hotel management.

Training programmes

We have conducted over 500 training programs, seminars, and workshops in major cities and towns in India addressed to corporates, businesspersons, executives, financial institutions, Banks, and development agencies.

- Entrepreneurship Development
- Faculty Development Programmes
- Seminars
- Business Meets

Publications

ITCOT brings out industry-specific publications and opportunity study reports with the objective of providing informational inputs on critical project parameters to enable enterprises and entrepreneurs to take appropriate investment decisions. So far, ITCOT has brought out over 100 such investor guidance reports on a wide cross-section of industry segments.

Entrepreneurial Guidance Bureau

An Entrepreneur Guidance Bureau exists in District Industries Centre to guide Entrepreneurs in various projects. The Bureau has a good collection of reference books on various projects, journals, magazines on various functional aspects of Industries. The Library also has project profile software consisting of projects for assisting the Entrepreneurs.

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2.4.10 Industrial Finance Corporation of India (IFCI)

IFCI Ltd. was set up in 1948 as Industrial Finance Corporation of India, a Statutory Corporation, through 'The Industrial Finance Corporation of India Act, 1948' of Parliament to provide medium and long term finance to industry. After repeal of this Act in 1993, IFCI became a Public Limited Company registered under the Companies Act, 1956. IFCI became a Government controlled company subsequent to enhancement of equity shareholding to 55.53 per cent by Government of India on 21 December 2012. In April, 2015, Government of India has acquired six crore Preference Shares of IFCI Ltd. of ₹10/- each from six public sector banks. With this, the shareholding of the Government of India in paid-up share capital of IFCI has been increased to 51.04 per cent and IFCI has become a Government Company under Section 2(45) of the Companies Act, 2013. IFCI is also a Systemically Important Non-Deposit taking Non-Banking Finance Company (NBFC-ND-SI), registered with the Reserve Bank of India.

The primary business of IFCI is to provide medium to long term financial assistance to the manufacturing, services and infrastructure sectors. Through its subsidiaries and associate organizations, IFCI has diversified into a range of other businesses including broking, venture capital, financial advisory, depository services, factoring etc. As part of its development mandate, IFCI was one of the promoters of National Stock Exchange (NSE), Stock Holding Corporation of India Ltd (SHCIL), Technical Consultancy Organizations (TCOs) and social sector institutions like Rashtriya Gramin Vikas Nidhi (RGVN), Management Development Institute (MDI) and Institute of Leadership Development (ILD).

Check Your Progress

6. What is the main objective of the DIC?
7. When was KVIC established?
8. What are the main objectives of the KVIC?

2.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The following are examples of internal factors:
 - Desire to do something new
 - Level of education

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- Technical education or technical background
 - Number of years of experience
 - Occupational knowledge and background
2. The external factors are dependent on the availability of resources, government's policies towards industrialization and policy makers' vision.
 3. Financial appraisal covers the following aspects:
 - The total capital cost of the project
 - The means of finance to meet the projected cost
 - The projected operating costs and revenues
 4. Asset-based finance is generally used for purchasing capital goods, which require a huge amount of money.
 5. Venture capitalists professionally manage money pooled from others. On the other hand, angel investors usually invest their own resources.
 6. The main objective of the DIC was to provide all the services and support required by small and cottage entrepreneurs under a single roof. It means that the entrepreneurs who previously had to go to different agencies for assistance/guidance, finance, training, technical advice, would now be provided with all these services in one place.
 7. The KVIC was established in 1956 by an Act of Parliament.
 8. The main objectives of the KVIC include skill improvement, providing employment in rural areas and transfer of technology, rural industrialization and promoting self-reliance among the people and to build a strong rural community base.

2.6 SUMMARY

- There are two types of factors that motivate an entrepreneur:
 - o Internal factors
 - o External factors
- Internal factors refer to a person's family background, his level of education and his desire to achieve. External factors are common to every individual and are outside the scope of any one individual. These factors are based on the availability of resources, government's policies towards industrialization and policy makers' vision.
- Finance is the lubricant in the operations of a project. It is required to meet both long term as well as short term requirements of the project. Short term

finance is needed to meet the day-to-day operations of a project or to supply working capital to a project. Long term need for finance is based on the size of operations. It is for acquisition of fixed assets.

- Financial appraisal is probably the most important aspect of project financing. There are various needs for finance in a project. Finding the means of obtaining finance to satisfy a particular need requires an understanding of the project operations and different activities of that project and its span of time and size.
- Some of the important forms of finances are overdraft, bank term loans, asset-based finance, receivables finance, invoice discounting, angel funding, venture capital, conventional loans, personal lease, operating lease, etc.
- The Government of India as well as State Governments have launched various support agencies such as DIC, SIDBI, SIDCO, SSIB, NSIC and SISI.
- The Industrial Policy Resolution of 1977 proposed the setting up of a District Industries Centre in each district headquarters of India. Based on the recommendations the District Industries Centre was established in 1978 and it became a landmark in the development of small and cottage industries in India.
- The main objective of the DIC was to provide all the services and support required by small and cottage entrepreneurs under a single roof. It means that the entrepreneurs who previously had to go to different agencies for assistance/guidance, finance, training, technical advice, would now be provided with all these services in one place.
- The DIC comprises a General Manager, four Functional Managers and three Project Managers.
- The Office of Development Commissioner, Small-scale Industries (DC-SSI), is also called the Small Industries Development Organization (SIDO). The office of the Development Commissioner Small Scale Industries (DC - SSI) is directly under the Union Ministry of Micro, Small and Medium Enterprises and is a nodal agency formulating, coordinating and monitoring the policies and programmes for the promotion and development of small-scale industries in the country.
- SIDO has over 60 offices and 21 autonomous bodies under its management. SIDO provides a comprehensive range of facilities for formulating, coordinating, and monitoring the small scale and micro enterprises sectors.
- Small Industries Service Institutes (SISIs) were set up by the Government of India to provide consultancy in the areas of project plan preparation

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and execution and training to small entrepreneurs. There are 28 SISIs working across the country. These are now known as MSMEDI (Development Institutes). There are close to 30 MSME-DIs in the country as of 2018.

- The State Industries Development Corporations were set up in various states under the Companies Act, 1956 to provide the primary development needs of tiny, small, village and cottage industries. In Andhra Pradesh, the Small Industries Development Corporation Ltd (SIDCO) was set up in 1960 for promoting and developing small scale industries in the state.
- In 1955, to encourage the growth of small scale industry in different parts of the country, the Government of India set up the National Small Industries Corporation (NSIC).
- Since its inception, NSIC has been serving the small scale industry, mindful of the industrial resolution policies and government industrial development plans in various Five Year Plan programmes. The wide range of services provided by NSIC is basically promotional in nature. It means that NSIC services are focusing on getting the machinery and equipment on hire purchase basis.
- The National Alliance of Young Entrepreneurs has made several schemes for entrepreneurs' development in collaboration with public sector banks such as Bank of India, Dena Bank, Punjab National Bank, Central Bank of India and Union Bank of India.
- The KVIC is a statutory organization established in 1956 by an Act of Parliament. The main objectives of the KVIC include skill improvement, providing employment in rural areas and transfer of technology, rural industrialization and promoting self-reliance among the people and to build a strong rural community base.
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- IFCI Ltd. was set up in 1948 as Industrial Finance Corporation of India, a Statutory Corporation, through 'The Industrial Finance Corporation of India Act, 1948' of Parliament to provide medium and long term finance to industry.
- The primary business of IFCI is to provide medium to long term financial assistance to the manufacturing, services and infrastructure sectors. Through its subsidiaries and associate organizations, IFCI has diversified into a range of other businesses including broking, venture capital, financial advisory, depository services, factoring etc.

*Factors Influencing
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2.7 KEY WORDS

- **Angel investor:** It refers to a financially sound or wealthy individual who can provide capital for starting a business, generally in return for ownership equity or convertible debt.
- **Chattel mortgage:** It is a loan arrangement in which an item of movable personal property acts as security for a loan.
- **Small scale industry:** It refers to those industries in which the manufacturing, production and rendering of services are done on a small or micro scale.
- **Factoring:** It is a financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount.

2.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the external factors that influence entrepreneurship?
2. What are the short-term requirements of a project?
3. Write a short note on Chattel mortgage.
4. What are the various economic development services provided by SISIs?
5. What are the objectives of the schemes introduced by the National Alliance of Young Entrepreneurs (NAYE)?

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Long-Answer Questions

1. Discuss in detail the important forms of finance.
2. Examine the prominent functions of DICs.
3. Analyse the role and functions of SIDCO.
4. Describe in detail the different kinds of services provided by TCOs.

2.9 FURTHER READINGS

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UNIT 3 BUSINESS IDEA GENERATION TECHNIQUE

*Business Idea Generation
Technique*

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Structure

- 3.0 Introduction
- 3.1 Objectives
- 3.2 Business Idea Generation Technique and Sources of Business Idea
- 3.3 Methods of Generating Ideas
- 3.4 Methods of Evaluating Ideas
- 3.5 Answers to Check Your Progress Questions
- 3.6 Summary
- 3.7 Key Words
- 3.8 Self Assessment Questions and Exercises
- 3.9 Further Readings

3.0 INTRODUCTION

Businessmen with entrepreneurial zeal rely on innovations or sense opportunities in order to nurture their organization. The opportunities and sources of new ideas are present everywhere. Businessmen rely on existing products, consumers, distribution channels, government, etc. to generate new ideas. There are broadly three methods of generating new ideas. They are brainstorming, focus groups, and problem inventory analysis. It is also important to evaluate business ideas. This can be done through market assessment and market feasibility studies. Evaluation of ideas helps us understand whether an entrepreneurial idea is a potentially successful one.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe idea generation technique and sources of business ideas
- Discuss the methods used for generating ideas
- Explain the importance of market assessment and market feasibility study in evaluation of ideas

3.2 BUSINESS IDEA GENERATION TECHNIQUE AND SOURCES OF BUSINESS IDEA

Business is all about ideas and sensing of opportunities. There exist some opportunities, created by other businesses and someone can sense it to make

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business out of it. For example, the Wright brothers invented airplanes, and some others saw an opportunity in it for transportation of people and goods. Some others saw services around the aviation industry as opportunities and now a complete echo system is developed around airplanes. In this process, several minds have added features to enhance safety, comfort and convenience. Just imagine the number of businesses around the aviation industry! Thus, new ideas are nurtured by some, but when they result into innovation, business opportunities are sensed by others.

Some business opportunities come on the way in the form of inquiry by someone, or could be visible because of demand-supply gap that one would study or know of. Here a businessman would enter, as it offers a relatively safe environment. An entrepreneur will sense opportunities of innovation or opportunities of creating an echo system around innovation that has happened.

A businessman who enters into a business because of existing opportunity can also be an entrepreneur if he runs his business with innovation and creativity, either in processes, development or growth.

Thus, entrepreneurial projects are the outcome of either innovations or sensing of opportunities for building an echo system around someone else's innovation, or they are an outcome of a businessman's entrepreneurial-like approach in nurturing the business.

Innovations result from persistent inquiry around a curiosity; innovations offer lots of business opportunities by building an echo system around it; and just existing opportunities can also improve the well-being of people if run with creativity and small innovative ideas.

Sources of Opportunities

Opportunities are everywhere. It is like 'eye the beholder'. Some see opportunities, some don't. Some even see opportunity in threats or failure.

The source of grassroots innovation, like that of Wright brothers, need just curiosity, relentless efforts, and of course a belief in oneself that 'we shall overcome someday'. This is a high risk area, as nothing is known in terms of outcome or even timeline for activities.

In case of existing innovation, creative thinking comes handy in sensing business opportunity that can build an echo system. An idea around innovation that can improve the quality of life of certain sections of people is more likely to yield positive results and contribute in building the echo system.

For a businessman with an entrepreneurial zeal the sources of opportunities could be grouped as under:

- (a) **Existing products and services:** Demand for products and services is always changing. The study of pattern in the demand and services, especially,

over the time (time series analysis of demand as well as supply) would reveal the gap, if anywhere demand exceeds supply. Such positive gap indicates business opportunity for an entrepreneur.

- (b) **Consumers:** Consumer enquiry often leads to newer business ideas. We have seen medical stores selling provision items. That is because consumers often ask them for provision items while buying medicines.
- (c) **Distribution channels:** Dealing with suppliers and customers also would generate more business ideas; again through inquiry or suggestion or some time sensing difficulties of distribution channel that one may observe.
- (d) **Government:** The government is always a big customer. Their purchase of goods and services are in volumes. Governmental needs also keep changing. That offers a good opportunity for doing business with the government. The government also acts as an investor in various social projects, even after economic liberalization. Private contractors, fabricators, suppliers and service providers get huge opportunities from government investment plans. The government often implements its programmes through private parties and non-government organizations.
- (e) **Research and development:** Those who are in business can create opportunities through a constant search for improvement in products, which can be best done by research and development activities. Research and development activity has to be guided towards some specific goals like product improvement, new product development, process improvements, cost effectiveness, design improvement, quality enhancement, and quality assurance among others. The goals have to be carefully chosen depending upon the market analysis and internal strategy with a view to getting best from investment in research and development.

Check Your Progress

1. How can business opportunity be created from existing products?
2. How are the goals for research and development chosen?

3.3 METHODS OF GENERATING IDEAS

Project ideas often have to be generated consciously and they have to be put to test before they can be called ideas. The methods of generating ideas can be grouped into the following three groups:

- Brainstorming
- Focus groups
- Problem inventory analysis

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(i) Brainstorming

Project ideas first pass through a brainstorming process. This is a judgemental process where all those who participate would rely on their own knowledge and perceptions.

(ii) Focus group

The participants in the brainstorming process would be organized depending on the type of idea. For example, an idea of replacing an old machine, (which is still working well) with a new and modern machine, would be discussed within the department. The idea of introducing a new variety of an existing product may be discussed at the higher level of production team combined with the marketing team; an idea of expanding into a new market territory may be discussed with the higher level marketing team along with the strategy group and a finance person. An idea of introducing a new product may be discussed in a high level team comprising the strategy group, the operations group and finance persons.

(iii) Problem inventory analysis

This is often known as inquiry. What would be inquired in the brainstorming dialogue? Again, it would depend on the project idea itself. However, we can list the points of inquiry which are as follows:

1. Does this idea make any sense?
2. Has anyone else done this project before? If yes, did any one succeed? If no, why do we think it would succeed here?
3. Can it be feasible in technical and marketing terms?
4. Does it look feasible financially?
5. How would this idea affect the product portfolio, current shape of business, etc.?
6. Does it fit in the strategic plan and strategic thrust areas of the business?

Participants in the brain-storming session would depend on their personal knowledge and perception. Therefore, participants with a broad spectrum of knowledge and experience blended with openness, vision and risk-taking ability would make a difference. Whistle-blowers do not give any service in the brain-storming dialogue.

The outcome of the brainstorming session, focus group activity and inquiry could be any one of the following:

- (a) Acceptance of the idea and decision to proceed further
- (b) Acceptance of the idea with modifications
- (c) Rejection of the idea

- (d) Initiations of the process of re-strategizing because the idea is so good that it should not be rejected just because it does not fit the current strategy.

Classification of Projects

Any size firm must have a system to facilitate the process of idea generation, for testing ideas, evaluating them and subsequently executing them for better effectiveness.

Classification of projects is the pre-requisite for creating an effective system of project planning and execution. Table 3.1 gives the basis of project classification.

Table 3.1 Classification of Projects based on Selected Criteria

Classification Criteria	Classification
1. Occurrence	Capital schemes and revenue schemes or routine and non-routine
2. Project size	Large and small
3. Types of benefits	Tangible and non-tangible or strategic and tactical
4. Degree of dependence	Mutually exclusive Complimentary Substitute
5. Nature of project	Replacement Addition/acquisition of production facilities Research and Development Maintenance facilities and services Housing, welfare and amenities
6. Type of cash flow	Conventional Non-conventional Annuity type Mix-stream

System for Idea Generation

A proactive organization builds a strong system for idea generation. There could be several formal, semi-formal and informal systems that can foster generation of project ideas. Depending upon the size and complexity of business, one has to choose a mix of system. The examples of formal, semi-formal and informal systems for idea generation are given in Table 3.2.

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Table 3.2 Systems for Idea Generation

Formal system →	A management committee Planning department or group Strategy group Periodic strategic planning exercise Management audit (also cost audit and functional audit) Periodic consulting by external expert Target costing mechanism Slack management system
Semi-formal system →	Suggestion box system and committees Innovation committees Joint departmental committees Quality circles Dialogue session and open house Value engineering groups Task forces and individual reports/Proposals
Informal system →	Individual experiments Individuals encouraged to work as task force

Formal and semi-formal systems would work better if a very clearly shared vision is evolved and if a strategic planning process is in place to provide trickle-down effect of strategic plans in the entire organization. However, shared vision is an issue mostly critical in a large organization and not in a smaller one. In an informal system, individuals are empowered to think and act creatively: for example, in 3-M company, Post-It product is the result of a failed experiment on a batch of adhesive material, followed by a creative search for a potential application of a special property (that it sticks but can be removed without stain and can be re-stuck) that was observed in the spoiled batch. A large fertilizer firm in Gujarat created managerial slack and built a system for slack management, in which even individuals were encouraged to envision and work on their own ideas that could help the company. Today, this firm gets many brilliant capital expenditure proposals initiated by individuals. Both semi-formal and informal systems support the formal system of capital expenditure idea generation.

Objectives of an Organizational System

Clarity of goals and objectives are pre-requisites for organizational effectiveness. A large organization aims at the following objectives, while designing the capital budgeting system:

- (i) Delegation of authority for timely decision without creating lack of harmony.
- (ii) Conducting efficient investment analysis by generating alternatives and making proposed opportunities holistic.
- (iii) Studying the risk involved in the proposed project and deciding on the suitable decision criteria.

- (iv) Removing bias in estimates, as those who propose projects are more likely to show upward bias on benefits and downward bias on costs of the project.
- (v) Bringing transparency in action.

Thus, methods of generating ideas would address the matters pertaining to the organizational system, classification of project and also clearly defined objectives of an organization system that is meant for nurturing and evaluating new ideas.

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Check Your Progress

3. What are the three methods of generating new ideas?
4. What do participants of the brainstorming session depend on?
5. What is the advantage of using an informal system for idea generation?

3.4 METHODS OF EVALUATING IDEAS

There can be many different methods of evaluating ideas:

- **Pass-fail evaluation:** This is a beneficial technique for sifting through a huge number of ideas. It involves setting up primary criteria including benchmarks like time-frame, budget, objectives, etc. against which ideas are to be judged. If the ideas clear this stage, they may be evaluated further on more detailed points.
- **Evaluation matrix:** It is a method in which experts use a set of criteria to judge the effectiveness of an idea. This is usually based on a point scale and experts are supposed to give points to different criterion aspects of ideas along with their comments on whether there are ways in their opinion on which the ideas may overcome their weaknesses. There is also an overall scoring system is also present.
- **SWOT analysis:** This is the most common approach. Under this, the reviewers are required to provide the potential Strength, Weakness, Opportunity and Threats of every idea submitted.
- **Pair wise analysis:** In this method, ideas are pitted against each other and by comparison, ideas are accepted or eliminated. This could also be done by giving ranks to different ideas based on set criteria.
- **Financial analysis** in the form of ROI, net present value, etc., can also be used for evaluating ideas.

3.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. The study of pattern in the demand and services, especially, over the time (time series analysis of demand as well as supply) would reveal the gap, if anywhere demand exceeds supply. Such positive gap indicates business opportunity for an entrepreneur.
2. The goals for research and development have to be carefully chosen depending upon the market analysis and internal strategy with a view to getting best result.
3. The methods of generating new ideas can be grouped into three categories:
 - Brainstorming
 - Focus groups
 - Problem solving inventory
4. The participants of the brainstorming session depend on their personal knowledge and perception.
5. The advantage of using an informal system is that individuals are empowered to think and act creatively. For example, in 3-M Company, Post-It product is the result of a failed experiment on a batch of adhesive material, followed by a creative search for a potential application of a special property (that it sticks but can be removed without stain and can be restuck) that was observed in the spoiled batch.

3.6 SUMMARY

- Entrepreneurial projects are the outcome of either innovations or sensing of opportunities. They can also be an outcome of a businessman's entrepreneurial-like approach in nurturing the business.
- For a businessman with an entrepreneurial zeal the sources of opportunities can be existing products and services, consumers, distribution channels, government, and research and development.
- Project ideas often have to be generated consciously and they have to be put to test before they can be called ideas. The methods of generating ideas can be grouped into the following three groups:
 - o Brainstorming
 - o Focus groups
 - o Problem inventory analysis

- Any size firm must have a system to facilitate the process of idea generation, for testing ideas, evaluating them and subsequently executing them for better effectiveness. Classification of projects is the pre-requisite for creating an effective system of project planning and execution.
- A proactive organization builds a strong system for idea generation. There could be several formal, semi-formal and informal systems that can foster generation of project ideas. Depending upon the size and complexity of business, one has to choose a mix of system.
- Clarity of goals and objectives are pre-requisites for organizational effectiveness. The methods of generating ideas would address the matters pertaining to the organizational system, classification of project and also clearly defined objectives of an organization system that is meant for nurturing and evaluating new ideas.
- Market assessment refers to systematic collection, recording and analysis of data. This data is used to develop an appropriate information base for decision making related to new product development or an existing product in marketing area. The more market-driven the venture, the greater are the chances of success.
- A market feasibility study is a structured and systematic analysis of the various aspects related to market area of a proposed entrepreneurial venture designed to determine its workability. A well-prepared feasibility study can be an effective evaluation tool to determine whether or not an entrepreneurial idea is a potentially successful one.

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3.7 KEY WORDS

- **Distribution channel:** It is a chain of businesses or intermediaries through which a good or service passes until it reaches the final buyer or the end consumer.
- **Brainstorming:** It is a method by which ideas are generated by participants who rely on their own knowledge and perceptions.
- **Market assessment:** It refers to systematic collection, recording and analysis of data. This data is used to develop an appropriate information base for decision making related to new product development or an existing product in marketing area.
- **Market feasibility study:** It is a structured and systematic analysis of the various aspects related to market area of a proposed entrepreneurial venture designed to determine its workability.

3.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What is a brainstorming session?
2. Write a short note on the system of idea generation.
3. Differentiate between formal market assessment and informal market assessment.
4. What is a market feasibility study?

Long-Answer Questions

1. Explain the sources of new business ideas for entrepreneurs.
2. Discuss in detail the different methods of generating new ideas.
3. Analyse the importance of market assessment and market feasibility study.

3.9 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
- Mohanty, S.K. 2005. *Fundamentals of Entrepreneurship*. New Delhi: Prentice Hall of India.
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UNIT 4 IDENTIFICATION OF BUSINESS OPPORTUNITIES

Identification of Business Opportunities

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Structure

- 4.0 Introduction
- 4.1 Objectives
- 4.2 Meaning of Identification of Business Opportunity
- 4.3 Sources of Entrepreneurial Opportunities
- 4.4 Opportunity Analysis
- 4.5 Answers to Check Your Progress Questions
- 4.6 Summary
- 4.7 Key Words
- 4.8 Self Assessment Questions and Exercises
- 4.9 Further Readings

4.0 INTRODUCTION

It is fundamental for entrepreneurs to develop the skill of recognizing a business opportunity. It enhances the entrepreneurial process as well as paves the way for the progress of a company. There are various sources of entrepreneurial opportunities. These sources of these opportunities can be personal interests or hobbies, work experiences, existing products, external environment, intuition, etc. Furthermore, it is important to assess the opportunity and examine the investment, technological aspect, and other important factors. This unit will discuss the sources of business opportunities in detail. The types of business opportunities and the process of assessment of the opportunities will also be discussed.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand business opportunities and the means of recognizing it
- Discuss the sources of entrepreneurial opportunities
- Examine the kinds of business opportunities
- Analyse the criteria for selection of a particular business opportunity

4.2 MEANING OF IDENTIFICATION OF BUSINESS OPPORTUNITY

If there is a business opportunity, shall one always grab it? Shall one drop some opportunities even if they are most lucrative? Most of you would be tempted to

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Material*

answer that an opportunity must be grabbed. But, that would not be right. Not everyone can make business out of a given opportunity. One needs to understand the 'strategic choice' of an opportunity.

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Strategic Choice

For a business, meeting investor expectations is very important. Investor's expectations are in terms of value creation. In a competitive business world, a firm has to trade carefully in pursuit of value creation. Therefore, a well-designed planning process begins with the definition of mission and philosophy followed by preparation of strategic plans, which are unfolded into the annual budgets before the operating plans are prepared and implemented.

Entrepreneurs should have the knack to recognize a business opportunity. This is fundamental to the entrepreneurial process as well as for building a business. A business opportunity represents a possibility for the entrepreneur to meet a large enough unsatisfied need. Significant research has been done on the opportunity recognition process and several models have been developed. One model that clearly identifies the aspects of this opportunity recognition process is indicated in Figure 4.1.

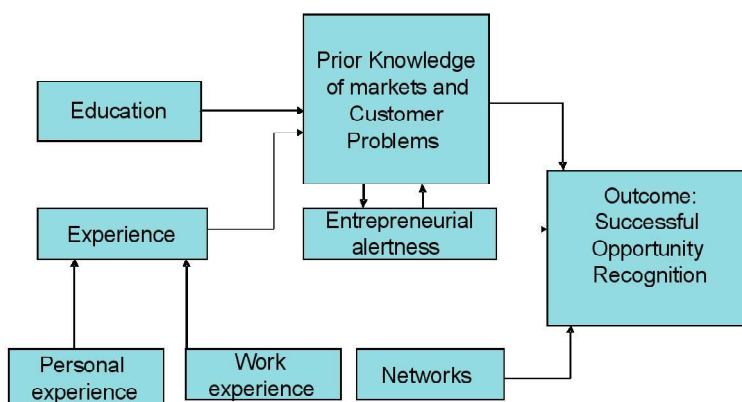


Fig 4.1 Model of Opportunity Recognition Process

Source: From Alexander Ardichivili and Richard N. Cardozo, 'A Model of the Entrepreneurial Opportunity Recognition Process', *Journal of Enterprising Culture*, Vol. 8, no. 2, June 2000.

Figure 4.1 indicates that the key to recognizing an opportunity lies in the knowledge and experience of the individual entrepreneur and, where appropriate, the entrepreneurial business. This prior knowledge is a result of a combination of education and experience, and the relevant experience could be work related or could result from a variety of personal experiences or events. The entrepreneur needs to be aware of this knowledge and experience and have the desire to understand and make use of it. The other important factors in this process are entrepreneurial alertness and entrepreneurial networks. There is an interaction between entrepreneurial alertness and the entrepreneur's prior knowledge of markets and

customer problems. Those entrepreneurs who can recognize meaningful business opportunities are in a strategic position to successfully complete the product planning and development process and launch new ventures.

(i) Corporate philosophy

Business philosophy is a self-imposed constraint, which defines what is acceptable and what is not acceptable to the businessman. This is a list of never-changing philosophy. The value system of a firm (mostly guided by the value system of the owner or chief executive officer and the members on the board of directors in case of a corporate business) builds an image of the business. Quite a few businesses observe very high ethical standards in doing business, follow the philosophy of not bribing anybody, not evading tax, and not having political alignments and undertake social development work, among others. Mission and philosophy are the moral commitments of a business. A well-defined value system can build a firm's public image and that way, the firm can acquire immunity against perils.

(ii) Strategic plans

The second important factor in value creation is 'synergy'. In a competitive world, there is a very narrow room for making money. Therefore, firms search for new projects that have synergy with the existing business. A broad plan for synergy is portrayed in the strategic plans of the company. Kotler Phillip wrote that 'strategic planning is the managerial process of developing and maintaining a viable fit between the organization's objectives and resources (on one side) and its changing opportunities (on the other). The aim of strategic planning is to shape and reshape the company's business and products, so that they combine to produce satisfactory profit and growth.'

Strategic planning attempts to attain the firm's objective and goals by utilizing the internally available resources for tapping external opportunities. The process of strategy making involves three distinct activities, which are listed as under:

- (a) Stating vision and setting goals
- (b) Identifying thrust areas, and
- (c) Making a strategic plan

Let us discuss these activities in detail.

- (a) Stating vision and setting goals:** There are two essential elements of business vision, namely, quantified goal and target date. In 1961, John F. Kennedy articulated his vision: 'Man on the moon by the end of the decade'. It was a dream at that time. However, that galvanized the entire NASA programme and Neil Armstrong actually set foot on the moon on 20 July 1969. A concrete goal and firm target date helped in resource allocation through the planning process and guided the actions, which made a lot of difference.

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A shared vision is essential for effective actions. Shared vision is the top management's vision, clearly understood and accepted by everyone in the organization and it is supported by a mechanism for addressing the issues, which may crop up when plans unfold. The last part of the previous statement is important because people who execute the plans are likely to face the hard reality of day-to-day life causing dilemma, conflict and frustration in their mind. The firms, whose leadership possesses the competence of managing the thorny issues involved in shared vision, can easily demonstrate the art of making things happen.

(b) Defining strategic thrust areas: Strategic thrusts are the ways of doing business to achieve strategic goals. For example, a firm may adopt a policy of doing business through emphasis on quality. One firm declared quality as their motto by making this statement in their strategic plan document: 'quality does not cost, poor quality does'. This firm defined the meaning of the term stating, 'not only the quality of our product and services, but also the quality of information and the quality of life of the people who live with us are important'. The purpose of strategic thrust areas is to provide guidelines to various business activities for decision-making and to integrate all activity areas in a single thread to eliminate the chance of disjointed efforts.

(c) Making strategic plans (strategic content and intent): Strategic intent and strategic content are vital in project management. Strategic goals and thrust areas form the strategic intent of the company. When strategic content is inserted in the plan, it becomes the strategic plan. In which direction a firm should grow and at what rate? What type of growth strategy must be adopted? The answers to these questions must be found in the strategic plans. Models are available for determining growth direction, growth rate and growth strategies suitable for a firm.

The growth direction decision is based on the analysis of strength, weaknesses, opportunities and threats (SWOT) in the areas of production and marketing. Based on the analysis, the firm may find it more synergic to grow in the direction of either current or related or new product line; or in the direction of current or related or new market line; or sometimes in the diagonal direction in which product and market both change to either related to new. The growth direction decision offers the line of thinking for the generation of new ideas that are more acceptable and more likely to create value.

Each firm has a distinct ability of managing growth, measured as a sustainable growth rate. The sustainable growth rate is a function of the ability to raise internal and external funds and managerial ability to manage growth. Several factors are evaluated in the models that guide through the sustainable growth rate determination. The sustainable growth rate decision, in turn, guides the size of capital budget.

Models on growth strategy decision, advise the company whether to take aggressive, conservative, competitive or defensive posture and whether to go for joint venture or some other kind of management contracts for sharing resources, or to go for a greenfield project or turnkey project. Several other growth strategies can emerge from the application of different growth strategy models.

Strategic plan provides the impetus and the guidance to various business activities in the preparation of their own strategic plans, which become a part of the strategic plan. Each decision taken as a part of the strategic planning process provides a line of thinking for new investment ideas and a line of thinking for brainstorming on new proposals. They also become the rational basis for negotiation and allocation of limited capital on competing projects.

Creating Environment

It is difficult to create a desired environment. Environment is invisible; it is manifested in un-proclaimed actions and behaviour of people. A culture conducive to creativity and efficiency is based on mutual trust and confidence. Though the policies, processes, paperwork and monitoring may be in place, objectivity is experienced in actions and behaviour. Results are important; means are also important, but more important are the motives behind actions. A good culture recognizes motives; bad intentions are punished and good intentions are rewarded irrespective of outcomes. Leadership style and organizational structure that suits the size and age of the organization create a culture fostering performance and creativity.

Bureaucratic culture kills good ideas. Less paperwork, less rule, simple procedures and the leader's willingness to take objective decisions and good motives are the signs of a creative environment.

Check Your Progress

1. State the benefit of having a well-defined business philosophy.
2. What is the aim of strategy planning?
3. What is the purpose of strategy thrust areas?
4. What are the signs of a creative environment?

4.3 SOURCES OF ENTREPRENEURIAL OPPORTUNITIES

Entrepreneurship researchers have looked at the sources of an entrepreneur's ideas. These studies have shown that the sources of their ideas are unique and varied. In one survey, 60 per cent of respondents said working in the same

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industry was the major source of ideas for business. For example, Vance Patterson, CEO of Patterson Fan Co. (www.pattersonfan.com), manufacturer of industrial fans, found two of his employees cooking hamburgers on an odd-looking grill. They had created the device out of spare parts, and it seemed that the odd shape of the flared fan parts kept the unit cooler than other grills and allowed air to circulate more evenly. Recognizing the uniqueness of the idea, he got a patent for the grill in his name and the names of the two employees who invented it, James Ballentine and Robert Carter. Another survey of 100 entrepreneurs who created some of the fastest-growing private companies in the United States showed similar results. An overwhelming majority (71 per cent) of the respondents replicated or modified an idea gained through previous employment. The next largest percentage of survey respondents in this particular study (20 per cent) said they got their ideas for an entrepreneurial venture from a serendipitous (coincidental) discovery.

Entrepreneurs might use numerous idea sources. These are shown in Table 4.1.

Table 4.1 Potential Sources of Entrepreneurial Ideas

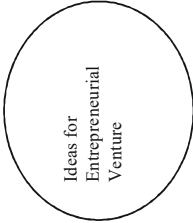
Sources		What to look for
• Hobbies or personal interests • Abilities, skills and work experience • Familiar and unfamiliar services and products External environmental opportunities in the legal-political, economic, demographic, socio-cultural and technological sectors		• Limitations of what is available at present • Approaches that are different and novel • Breakthroughs and advances • Niches that are unfilled • Changes and trends

Table 4.1 illustrates some of the more common sources and what to look for while exploring them. Let us look more closely at the four main sources of ideas.

1. Personal interests or hobbies: Many entrepreneurial ventures were formed because of an entrepreneur’s love of doing something such as restoring antique automobiles, scuba diving, baking grandma’s scrumptious praline chocolate brownies, etc. A successful entrepreneurial business might be built around one’s personal interests in a particular product or activity.

2. Work experiences, knowledge and skills: By tapping into the knowledge of a particular industry or market gained by working in it, an entrepreneur can pinpoint areas of potential opportunity. For example, if you’ve ever travelled, you’ve undoubtedly seen those suitcases with wheels. Now wasn’t that a great idea! Robert Plath created the first wheeled suitcase, the Travelpro Rollerboard, because in his job as an airline pilot he was constantly carrying his bags from one place to another, and he was looking for a more convenient, comfortable way to

do so. In the process of using his work-related experiences and knowledge, he created not only a new product but also a new industry!

3. Products and services currently available (both familiar and unfamiliar): What products do you use everyday? Do they do everything that you wished they would? What about products you are not familiar with? Can you take what you are familiar with and apply it to those unfamiliar ones? Answers to the above questions are sources of idea generation to an innovative entrepreneur.

4. External environment: Positive trends or changes provide unique and distinct possibilities for innovating and creating value in the entrepreneurial context. These opportunities can be found in the technological, societal culture, demographics, economic and legal-political sectors.

Those were the potential sources of entrepreneurial ideas, but what are the specific things that an entrepreneur should look for? Basically, he should look for changes and trends, unfilled niches, breakthroughs and technological and scientific advances, different and new approaches, and limitations of what is currently available. Any of these could provide a potential idea for an entrepreneurial venture. But, perhaps this is not enough. Even with the wide variety of idea sources, an entrepreneur may have difficulty in coming up with an idea for his entrepreneurial venture. At this point, he may want to use some different, more structured approaches to help generate ideas. There are four different structured approaches that he might use:

- (i) Environmental scanning
- (ii) Creativity and creative problem solving
- (iii) Brainstorming, and
- (iv) Focus groups

Let us discuss these approaches.

- (i) **Environmental scanning:** Does the aspiring entrepreneur know the latest scoop on what is happening in the business world? Has he read the latest news headlines? Does he know what books or movies are popular right now? If yes, it is an indication that has a good environmental scanning ability. One technique that entrepreneurs can use to generate ideas is environmental scanning, the process in which huge quantities of information are screened for detecting the trends that may be emerging. Here are some 'ideas' to stimulate one's own idea creating by scanning the world around: Read the local and other major metropolitan newspapers (*The Hindu, New York Times, The Washington Post, USA Today*, and others); read business publications (*Business Line, Economic Times, Business Week, Fortune, Financial*

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Times, *Fast Company*, *Wall Street Journal*, and others); read popular consumer and new magazines, review the fiction and nonfiction best-seller lists; review government and consumer publications; subscribe to relevant trade publications; pay attention to commercials; watch and review top prime-time television shows; browse the magazine section of bookstore; walk through a local shopping mall to see what is there; and so forth.

- (ii) **Creativity and creative problem solving:** This is the capability for combining ideas in a distinct manner or making unusual connections between them. It means cross-thinking by seeing new angles, connections and approaches. The whole area of creativity has been extensively researched and studied, resulting in a lot of information—all of which cannot be covered here. Instead, what can be understood about the role of creativity and creative problem solving as a structural technique for generating ideas is that a number of specific creativity approaches can be used. Here are a few specific techniques:

- (a) **The checklist method**, in which an entrepreneur uses a list of questions or statements to develop new ideas;
 - (b) **Free association**, whereby an entrepreneur develops a new idea through a chain of word associations;
 - (c) **Attribute listing**, in which an entrepreneur develops a new idea by looking at the positive and negative attributes of a product or service.
- Using any of these structured creative problem-solving approaches can help an entrepreneur unlock his creativity and generate potential entrepreneurial ideas. If he needs more information on how to be creative, he can research the topic at the library or on the Internet.

- (iii) **Brainstorming:** It is one of the most familiar and widely used techniques to generate ideas. It is an idea-generating process for developing creative solutions that encourages as many alternatives as possible while withholding criticism. Brainstorming is a relatively simple technique that is typically done with a group of people. (You could do this with friends or colleagues.) In a brainstorming session, a group of people gets together in a room, preferably one with a relaxed environment, where everyone is free to stretch their minds and think out of the box. A group leader states the issue or problem to be addressed and ensures that all participants understand it. The members contribute as many ideas as they can in a given time by describing them verbally (often shouting them out). Participants are encouraged to come up with as many ideas as possible and to build on each others' ideas. No criticism of ideas is allowed during the brainstorming session. Instead, all ideas, no matter how illogical or crazy, are recorded for later discussion

and analysis. Brainstorming is an idea-generating process that opens up many alternatives. It can be a frenzied, yet productive way to generate numerous ideas.

- (iv) **Focus groups:** The final structured approach to generating ideas is the use of focus groups. These groups of individuals provide information about proposed products or services in a structured setting. In a typical focus group, a moderator focuses the group discussion on whatever issues are being examined. For instance, a focus group might look at a proposed product and answer specific questions asked by the moderator. In other instances, the focus group might be given a more general issue to discuss and the moderator simply leads the discussion based on comments made by the group. Either way, a focus group can provide an excellent way to generate new ideas and to screen proposed ideas and concepts.

5. The role of intuition: We cannot leave our discussion of generating ideas without looking at the role of intuition. Intuition is cognitive process whereby we subconsciously make decisions based on our accumulated knowledge and experiences. It has been called that ‘Aha feeling you get when your internal search engine hits its mark’. It may also be called ‘gut feeling’. Researchers have shown that a person’s intuition can be measured. Measure yours by using the FYI box titled ‘As Good As a Guess’. Although structured, methodical approaches to generating ideas are important, intuition can also play an important role. Intuition can be a powerful source of new ideas. Maybe the best approach of all would be to combine the structured with the intuitive. After all, the two complement each other. Entrepreneurs can listen to that ‘inner voice’ and then use more structured approaches to fine-tune their ideas. Although generating ideas is an important process for entrepreneurs, it is only half the battle! Ideas have to be carefully examined before taking action and proceeding with an entrepreneurial venture.

6. Other sources of business or product ideas

- **Emerging new technologies and scientific know how:** Commercial exploitation of indigenous or imported technologies and know how are other sources of business for entrepreneurs in developing countries, especially in the case of import substitute product manufacturing.
- **Trade fairs and trade journals:** Magazines, journals, industries or trade fairs offer wide scope for business opportunities to aspiring entrepreneurs of developing countries like India in the area of small scale and tiny sectors.
- **Social and economic trends:** Social and economic status of people is always dynamic in nature and offers wide opportunities. An entrepreneur should observe such changes. For example, there is a shift towards

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readymade garments; possessing consumer durables, retail shopping malls, Western outfits, priority and preferences for cosmetics, etc.

- **Changes in consumption pattern:** Entrepreneur should pay attention to the consumption levels or habits of domestic as well as foreign consumers.
- **Market characteristics:** Aspiring entrepreneurs should study market characteristics to get a wide range of business ideas. Unfulfilled demand of a product will open the door for a new product. Supply and demand of various products and demand for new products should also be analysed.
- **Product profile:** An analytical study of the end products and by products can be the genesis of new project ideas. For example, byproducts of the sugar industry gave rise to one more large scale industry, the paper industry.
- **Import and exports:** The Government of India is encouraging exports and various Export and Import (EXIM) policies encourage entrepreneurs to think about new options.
- **Stimulation of sick units:** Investment on a sick unit is highly risky but a sick unit gives ample investment opportunities to a dynamic entrepreneur. He can stimulate and turn a sick unit into a profitable one.

Check Your Progress

5. What is environmental scanning?
6. What is the checklist method?

4.4 OPPORTUNITY ANALYSIS

The role of entrepreneurship in economic development varies from economy to economy depending upon human and material resource, industrial environment, and the importance attached to entrepreneurial growth by the political system. The emergence, working and growth of entrepreneurs are facilitated in those economies where favourable conditions exist.

According to Peter F. Drucker, an entrepreneur must be capable of analysing the opportunities and exploiting them successfully. According to him, opportunities are of three kinds.

- Additive opportunities
- Complementary opportunities
- Breakthrough opportunities

Additive opportunities are those which enable the decision maker to better utilise the existing resources without in any way changing the character of a business.

Complimentary opportunities involve the introduction of new ideas and as such lead to a certain amount of change in the existing structure.

Breakthrough opportunities on the other hand involve fundamental changes in both the structure and character of the business.

Final Selection

According to David H. Holt, 'Business opportunity is defined as the identification of a gap in "need" and the likelihood that if a product were developed to fill that need, it would also be "wanted" (i.e. there would be effective consumer demand). This idea may be born of entrepreneurial insight, creative mind-mapping, or accidentally stumbling upon an idea through a corridor of related activity.'

Opportunities, according to Drucker, are of three kinds: (i) Additive (ii) Complementary and (iii) Breakthrough. Additive opportunities are those which enable the decision-maker to better utilize the existing resources without in any way involving a change in the character of business. These opportunities involve minimum disturbance to the existing state of affairs and hence the least risk. Complementary opportunities involve the introduction of new ideas and as such do lead to a certain amount of change in the existing structure. Breakthrough opportunities, on the other hand, involve fundamental changes in both the structure and character of business. These opportunities involve minimum disturbance to the existing state of affairs and hence the least risk. The element of risk is greater in the case of complementary opportunities and is greatest in the case of breakthrough opportunities. As the element of risk increases, it becomes more important to precisely define the scope and nature of the project objectives and to select the best possible approach so as to minimize both resource consumption and risks and to optimize the return or gains.

In free-enterprise systems, markets for new services and products emerge from the needs and wants of consumers. Opportunities are identified by entrepreneurs on the basis of both needs and wants. For instance, it was recognized by furniture maker Paul Bush that there was a need for some base that electronic products could sit on – desks customized for holding microcomputer workstations, VCR cabinets and TV stands were required by home consumers. Therefore, heavy investment was made by Bush in market research, as a result of which it came to light that similar products that already existed in the market were ugly and flimsy. It was also discovered by him that there were only a few firms that manufactured computer workstations, and there was a wide gap between functional metal desks (altered typewriter stands) and trendy office furniture designed specially for PCs and word processors. Bush made optimum use of this opportunity and came up with his line of products to cater to this requirement. The observant mind continuously comes across situations which can be utilized to develop investment

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opportunities. The observation may be made during the course of one's routine occupation or otherwise.

Criteria for Selecting a Particular Business Opportunity

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Following the identification of an opportunity, by any means, whether through inputs received from technical people, channel members, business associates, or consumers, careful screening and evaluation of it are required. Evaluating the business opportunity is perhaps the most crucial aspect of the entrepreneurial process because it assists entrepreneurs in assessing whether the particular service or product provides sufficient returns in comparison to the resources needed. Such a process of evaluation takes into account the duration of the opportunity, the returns and risks involved as well as the idea's real and perceived value. It also involves considering whether it corresponds to the entrepreneur's goals and skills, as well as the distinctness or differential advantage that it enjoys in its competitive environment. After gathering a large number of business opportunities, the entrepreneur should consider the following criteria for selecting a particular business opportunity.

1. *Investment size:* Capital requirement and the risk aspect and gestation period of the project influence the evaluation process. Professional managers, who have worked in multinational companies or large Indian companies, should think of starting medium-sized or large-sized units only. The investment size (project cost) should be between `3 and `5 crore. They should not make the common mistake of restricting the project size to less than `2 crore. In fact, under the present circumstance, it will be much easier to get projects cleared by the all-India institutions, requiring even less contribution from the promoter.
2. *Location:* This is the second influencing factor in the selection criteria of the project. The theories suggest that projects should be located close to human resources and raw material availability. A new entrepreneur should locate his project in and around the state headquarters. There are many backward areas around such cities. It is necessary to be located in such a place where entrepreneurs can attract competent managers. This will also facilitate liaison with the State Electricity Board, State Industrial Development Corporation and various other agencies.
3. *Technology:* What type of technology is required? Should it be indigenous or foreign collaboration? Is the required skilled manpower readily available in the job market? These questions are answered in the next stage of the selection process of project. The first project should not be for a product which requires high technology, necessitating foreign technical collaboration. It is better to go in for a product with proven technology that is indigenously available. It makes life easier to begin with.

4. *Equipment*: The quality of a product not only depends on the raw material that the entrepreneur uses but also on the quality of equipment that he uses in the manufacturing process. The entrepreneur should select the best equipment as advised by experienced technical consultants. He should not compromise on the quality of the equipment. Many entrepreneurs enter into some sort of a deal with the equipment manufactures for a 'kick-back' and in the process sacrifice quality. One should not be short-sighted and come to grief by going in for poor quality equipment.
5. *Marketing*: The market size and opportunity of product or service have to be investigated with the help of Market Survey and Assessment Research Reports. It is not advisable to get into a project, particularly the first, which would mean survival amidst cut-throat competition involving direct selling to the ultimate consumer. One should go in for products with a limited number (say 10 to 20) of industrial customers.

An opportunity assessment plan is also inclusive of the source of capital for financing the initial venture and its growth, the resources required for translating the opportunity into a practical business enterprise venture, specifications of all the activities, an assessment of the entrepreneur and the team and descriptions of the service or product. In order to assess the opportunity, the following questions need to be addressed:

- What market need is fulfilled by it?
- What personal observations have been recorded or experienced in terms of market need?
- What are the social conditions underlying this market need?
- What market research data needs to be marshalled for describing this market need?
- What are the patents that might be available for fulfilling this need?
- What does the internal competition look like?
- What does the international market look like?
- Where can money be made in this activity?
- What technological requirements need to be fulfilled?
- What environmental and licensing requirements need to be fulfilled?

Check Your Progress

7. What, according to Peter F. Drucker, are the three kinds of opportunities?
8. What are additive opportunities?

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4.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A well-defined business philosophy can build the firm's public image and that way, the firm can acquire immunity against perils
2. The aim of strategic planning is to shape and reshape the company's business and products, so that they combine to produce satisfactory profit and growth.
3. The purpose of strategic thrust areas is to provide guidelines to various business activities for decision-making and to integrate all activity areas in a single thread to eliminate the chance of disjointed efforts.
4. Less paperwork, less rule, simple procedures and the leader's willingness to take objective decisions and good motives are the signs of a creative environment.
5. Environmental scanning refers to the process in which huge quantities of information are screened for detecting the trends that may be emerging.
6. The checklist method refers to the method in which an entrepreneur uses a list of questions or statements to develop new ideas.
7. According to Peter F. Drucker, opportunities are of three kinds:
 - a. Additive opportunities
 - b. Complementary opportunities
 - c. Breakthrough opportunities
8. Additive opportunities are those which enable the decision maker to better utilise the existing resources without in any way changing the character of a business.

4.6 SUMMARY

- Entrepreneurs should have the knack to recognize a business opportunity. This is fundamental to the entrepreneurial process as well as for building a business.
- The key to recognizing an opportunity lies in the knowledge and experience of the individual entrepreneur and, where appropriate, the entrepreneurial business. The other important factors in this process are entrepreneurial alertness and entrepreneurial networks.
- Business philosophy is a self-imposed constraint, which defines what is acceptable and what is not acceptable to the businessman. A well-defined

value system can build a firm's public image and that way, the firm can acquire immunity against perils.

- The second important factor in value creation is 'synergy'. In a competitive world, there is a very narrow room for making money. Therefore, firms search for new projects that have synergy with the existing business.
- Strategic planning attempts to attain the firm's objective and goals by utilizing the internally available resources for tapping external opportunities. The process of strategy making involves three distinct activities, which are listed as under:
 - (a) Stating vision and setting goals
 - (b) Identifying thrust areas, and
 - (c) Making a strategic plan
- Entrepreneurship researchers have looked at the sources of an entrepreneur's ideas. These studies have shown that the sources of their ideas are unique and varied. Four main sources of ideas are personal interests or hobbies, work experiences, existing products, external environment, intuition, etc.
- The role of entrepreneurship in economic development varies from economy to economy depending upon human and material resource, industrial environment, and the importance attached to entrepreneurial growth by the political system. The emergence, working and growth of entrepreneurs are facilitated in those economies where favourable conditions exist.
- According to Peter F. Drucker, an entrepreneur must be capable of analysing the opportunities and exploiting them successfully. According to him, opportunities are of three kinds.
 - o Additive opportunities
 - o Complementary opportunities
 - o Breakthrough opportunities
- Additive opportunities are those which enable the decision maker to better utilise the existing resources without in any way changing the character of a business. Complimentary opportunities involve the introduction of new ideas and as such it leads to a certain amount of change in the existing structure. Breakthrough opportunities on the other hand involve fundamental changes in both the structure and character of the business.
- According to David H. Holt, 'Business opportunity is defined as the identification of a gap in "need" and the likelihood that if a product were developed to fill that need, it would also be "wanted" (i.e. there would be effective consumer demand).

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- Following the identification of an opportunity, by any means, whether through inputs received from technical people, channel members, business associates, or consumers, careful screening and evaluation of it are required. Evaluating the business opportunity is perhaps the most crucial aspect of the entrepreneurial process because it assists entrepreneurs in assessing whether the particular service or product provides sufficient returns in comparison to the resources needed.
- After gathering a large number of business opportunities, the entrepreneur should consider the investment size, location, technological aspects, equipments, marketing aspects, etc.

4.7 KEY WORDS

- **Strategic planning:** It is the managerial process of developing and maintaining a viable fit between the organization's objectives and resources (on one side) and its changing opportunities (on the other).
- **Corporate philosophy:** It refers to the vision, value-system and mission of the company.
- **Intuition:** It refers to a cognitive process whereby we subconsciously make decisions based on our accumulated knowledge and experiences.
- **Breakthrough opportunities:** This is concerned with making fundamental changes in both the structure and character of the business.

4.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the advantages of adhering to a well-defined business philosophy?
2. What do you mean by strategic planning?
3. What is environmental scanning?
4. Write a short note on business opportunity.

Long-Answer Questions

1. Discuss the three important activities that are part of strategic planning.
2. Examine the main sources of entrepreneurial ideas.
3. Explain the criteria considered while selecting a particular business opportunity.

4.9 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
- Mohanty, S.K. 2005. *Fundamentals of Entrepreneurship*. New Delhi: Prentice Hall of India.
- Desai, Vasant. 1997. *Management of Small Scale Industries*. New Delhi: Himalayan Publishing House.
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Identification of Business Opportunities

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Self-Instructional Material

BLOCK - II

MARKETING AND TECHNICAL ANALYSIS

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UNIT 5 MARKETING FEASIBILITY

Structure

- 5.0 Introduction
 - 5.1 Objectives
 - 5.2 Phases of Feasibility Study
 - 5.2.1 Types of Feasibility Studies
 - 5.3 Marketing Strategies
 - 5.3.1 Specialist Roles Open to Market Nichers
 - 5.4 Financial and Economic Feasibility
 - 5.5 Classification of Sources of Finance
 - 5.6 Answers to Check Your Progress Questions
 - 5.7 Summary
 - 5.8 Key Words
 - 5.9 Self Assessment Questions and Exercises
 - 5.10 Further Readings
-

5.0 INTRODUCTION

An important aspect of a new product idea or a project is the market analysis. It is important to assess the potential sales revenue from the proposed idea or project. The market feasibility of a project depends on the type of product that is being introduced. It is only after assessing the market feasibility that the marketing strategy is prepared. Furthermore, the economic and financial feasibility also needs to be examined. This unit will discuss in detail the components, types and phases of marketing strategy. The external and internal sources of finance will also be explained. The role of financial institutions will also be highlighted.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss market feasibility
- Understand the components, types and main phases of marketing strategy
- Explain the prerequisites of financial and economic feasibility
- Analyse the external and internal sources of finance
- Discuss the role of financial institutions

5.2 PHASES OF FEASIBILITY STUDY

Nowadays private consultancies are doing feasibility studies on different types of project works. Generally they divide the feasibility study into four stages with a specific systematic procedure and in each stage generate certain reports to make the client understand and to get the permission to proceed to next stages. The stages of a feasibility study, normally, are:

Conceptual Stage

The client's business needs are analysed, information is gathered from the project participants' and also analysed at the conceptual stage. Priority was given to study the client's expectations for system implementation and the proposed solution is offered. In this stage in consideration of client needs, the goals, restrains and parameters of the project were agreed and included with the observations on:

- Budget on project and regulations for its adjustment
- Time frame of project
- Solution of problems in the conceptual stage of project

The tasks performed at the conceptual stage are:

- Determining the scope and estimate of the project feasibility
- Identifying the benefits and risks of the project
- Elaborating the structure of the project
- Planning the project roughly
- Brief planning for the next project stage
- Assessing the cost of the next phase and approximately evaluation the cost of the other phases
- Determining the priorities on functionality development
- Estimating the various risks in the creation of system

The following documents are available by the end of this phase:

- A report on feasibility study (feasibility report) that exhibits the description of the proposed solution and lists out functional requirements;
- The project structure which describes the project organization
- The project plan which has the description of the project schedule
- The risk list showing possible project risks and potentialities of their elimination

The feasibility report must be duly signed by the client. Once the client has signed on this report, it means that the client and the project team both have a common understanding on the goals and tasks of the project and have reached an

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agreement on the process for project implementation. The average length of this phase is about ten percentage of the total project duration.

Elaboration Stage

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In this stage, the following tasks are performed by the project team:

- Analysis of the client's hopes and requirements
- Defining the architecture of the system, its components and functionality.
- Designing the system based on the analysis results
- Enhancing the accuracy on the matter of timing

At this phase the following documents are created:

- With a plain explanation of the system functionality, logical data model and system architecture a document is created named as 'Specification on functionality'
- The other document at this phase is report on project fine storage structure and the regulations for system building name as 'Plan on Configuration Management'.

The specification on functionality must be duly agreed and signed by the client, which means that the client and the project team have reached an agreement on the following points:

- Client's problem should be solved in under the terms and conditions of the project restrictions
- Project risk should be understood and shared with the customer
- Project cost, duration of project time and project functionality are collectively planned.

Testing the plan is very important after the documents are ready. The document name may differ based on the on the customer's technology needs, for example some may call a document System Requirements Specification and others may called it as Requirements Specification for Systems, etc. The plan testing/ describes the testing procedures for the project. This phase generated a thoroughly documented solution as a result, which helps the client to develop a fully functional system on time and within the allocated budget funds. At the end of this stage, the client can know a more precise evaluation of project implementation cost and time. The average period of this phase is about 30 per cent of the total project duration.

Construction/Stage

If the system requirements are not completed in the previous stage, the project team focuses on determining the system requirements at this stage. In this stage, the system is developed based on the analysis and design performed at the previous stage.

At this stage the following tasks are fulfilled:

- Based on the results of development, the definition of the system requirements are looping, it means that system requirements are constant until complete the goals of project
- Coding of system components is done
- Integration of system components has taken place
- Trail testing of system
- Risk management on project is done based on the requirement from time to time updating project documentation
- User and technical manual is prepared

The technical specification of a system is created and updated along with the coding advances. A detailed description of the system architecture is in the technical specification of system. The chief purpose of this stage is to deliver complete a full-scale operational application to the client and installed into the actual working environment for further modification, configuration on the customer's hardware and setup. The testing starts soon after the coding and integration are completed and test specification is created in advance. At the client's site the plan for system implementation developed after system development and testing. The document contains the following information:

- Duration of implementation timing
- List and schedule of the implementation tasks
- Required resources
- Job responsibilities and their implementation

The on and above average length of this phase is 50 percentage of the total project duration.

Project Implementation

The completely developed and tested system was delivered by the project team at this phase to the client. Several repetitive tasks are present in this phase, which includes the level of client receipt testing and modification of system on the results of this testing and client feedback. A letter of acceptance will be given by the client duly signed by him/her after acceptance testing. At this phase, the following tasks will be performed by a plan developer:

- Installing the system at the client's site
- Integrating the system according to the client's technology
- Configuring the system
- Providing training to the end users

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By the end of this phase, an application corresponding to the functional specification will be received by the client. The application is a very reliable one if the client wants to expand the system functionality. After the successful completion of the implementation phase, the system is enhanced within the framework of a new project. A functioning version of the system will be supplied to the customer, with iterative system development and add functionality to the existing system. The average length of this phase is about 10 per cent of the total project duration. The client makes a decision on project closing after this phase is successfully completed.

With all the four stages complete, the client benefits by the feasibility study and make the project a reality with his knowledge in diversified area start-up of the enterprise. This is a multi-purpose activity taken up by private consultancies for mutual benefit.

5.2.1 Types of Feasibility Studies

Some investment proposals pass through the stage of project feasibility study. Large projects usually need a feasibility test before a significant amount of money is committed. The strategic content in such projects is high but availability or relevance of internal data is less. Feasibility study is a test where *prima facie* viability of investment is evaluated. Evaluation is based on secondary but comprehensive data. Rough estimates based on the experience of others form the basis of the viability check in the project feasibility study. There are basically three types of project feasibility study:

- (a) Market feasibility
- (b) Technical feasibility
- (c) Financial feasibility

When projects are evaluated by government or government agencies, economic and social feasibilities are also considered, in addition to the environment assessment. Market feasibility is carried out in detail at this stage. Technical feasibility and financial feasibility are less emphasized at this stage.

A. Market feasibility

Market analysis aims at assessing the potential sales revenue from the proposed project. This is also known as market-feasibility study.

Approach for conducting market-feasibility study would vary depending upon the type of the proposed product. In case of a novel product idea (product is novel if the same or similar product is not in the market anywhere in the world), market-feasibility check has to be based on absurd judgement and wishful thinking. If a proposed product is new in an economy, and is marketed successfully in some other economy, its market feasibility is assessed through a meaningful comparison of some broad economic and cultural indicators in two economies. But if the

proposed project is added to the capacity existing in the economy, the task of market-feasibility study will be different. The following discussion is centred on the market-feasibility study for that product which is already selling in the market. It is divided into five points:

- (i) **Study of general economic factors and indicators:** Some of the important economic indicators include gross domestic product, per capita income, income disparity, rate of urbanization, population growth rate, literacy rate, government spending, money supply and others.
- (ii) **Demand estimate:** Salient points related to demand estimation are end-user profile, study of influencing factors, regional, national and export market potential, infrastructure facilities which may facilitate or constrain demand and demand forecasting.
- (iii) **Supply estimate:** Supply estimate is not easy. Past trend of supply of goods can be studied and further extrapolated. Projections so made need to be adjusted with the help of additional information like new projects planned by businesses in the economy, import possibility as governed by the import policy, import tariff and international prices.
- (iv) **Estimating demand-supply gap:** Demand and supply estimates, fine-tuned with the changing factors, are now compared with each other for finding a gap. It is quite likely that the forecast of demand and supply may not be a single point forecast. It may be in terms of various scenarios. The demand and supply projections are given in Table 5.1, which also shows calculation of demand-supply gap for a particular product in five consecutive years.

Table 5.1 Demand-Supply Gap Calculation for Five Years

Year	Cement Demand			Cement Supply		Demand Surplus		
	Min.	Likely	Max.	Likely	Max.	Min.	Likely	Max.
1	48.00	48.00	48.00	48.00	48.00	0.00	0.00	0.00
2	49.44	50.40	51.36	50.70	50.70	- 1.26	- 0.30	0.66
3	51.66	53.93	56.50	53.38	63.24	- 11.58	0.55	3.12
4	54.76	58.78	63.84	61.03	65.46	- 10.70	- 2.25	2.81
5	58.60	65.25	74.69	62.45	53.38	5.22	2.80	12.24
Demand Surplus: Minimum = Min demand - Max Supply								
Likely = Likely demand - Likely Supply								
Maximum = Max demand - Likely Supply								
Note: All the confirmed capacity additions constitute 'likely supply scenario', while 'maximum supply scenario' assumes another capacity addition in the third year to fifth year. It is assumed that firms will be able to operate at 80 per cent capacity.								

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- (v) **Critical Success Factors:** Success of a project depends on the actual outcome of some key variables. Those key variables are called critical success factors. Inaccuracy and uncertainty surrounding those factors may render the project unattractive. Each industry has its own critical success factors identified from the experience of businesses. For example, in case of a cement project, availability of limestone, availability of wagons, freight charges, supply of power and supply of coal are the key success factors, as they generally constitute 65 per cent of the variable cost and 40 per cent of realization.

In case of an aluminium project, power which accounts for more than 60 per cent of realization is the critical success factor, transportation facility for any bulk goods producer, supply of skilled manpower in case of information technology industry are examples of the critical success factors. Critical success factors are product and region specific. Some of the factors are project specific, and others are specific to the economy and location. Risk is studied in the light of possible variations in the critical success factors.

B. Technical Feasibility

If there is an ample market demand without enough supply, the focus should shift over to technology. The following inquiries must be made with respect to technology analysis:

- (a) Availability of commercially exploitable technology and its alternatives.
- (b) Transferability of those technologies
- (c) Other inquiries about the technologies
 - Normal capacity utilization
 - Requirement of plant and equipment and fabrication facility
 - Production process needed
 - Possible product mix
 - Possible alternate usage
 - Flexibility
 - Rate of change
 - Waste disposal
- (d) Risk implications
- (e) Resource availability

C. Financial Feasibility

Demand and price estimates are derived from the market feasibility study. Project costs and operating costs are derived from the technical feasibility study. The estimates need to be supplemented with tax implications depending upon the

prevailing tax laws and financial costs emanating from the financing alternative considered for the project. This provides enough information for the calculation of the financial bottom line of the project.

The financial feasibility check involves a detailed financial analysis. Financial analysis includes quite a few assumptions and calculations. This will be discussed in detail in the next section.

Demand forecasting techniques

Now that you have learnt about the phases of feasibility, let's discuss one of the most important elements of market feasibility study: demand forecasting techniques.

Business managers are expected to know and apply the forecasting techniques in their decision-making process. A number of methods and techniques have been developed in the last few decades for forecasting the future. These can be separated in two broad classes, namely, quantitative techniques and qualitative techniques. Quantitative techniques find solution directly based on historical data. Qualitative techniques aim at forecasting changes in a basic pattern. Qualitative techniques are used for forecasting a turning point in the pattern: for example, forecasting an expected decline in the demand of a product, which has touched the maturity point.

The choice of forecasting technique is of vital importance because historical data analysed by them may have different patterns and also the future for which forecast is made may have some of the factors in variation as compared to what they were during the relevant period of historical data. Forecast is divided into two points—pattern-based forecast and causal model-based forecast.

- (i) **Pattern-based forecast:** Where one or few independent factors may not have explanatory power for demand, just the pattern of demand over time can be studied for forecasting purpose. Therefore, patterns are observed over time-line. There are various patterns of historical data like horizontal pattern, seasonal pattern, cyclical pattern and growth pattern. Figures 5.1A to 5.1D gives the pictorial presentation of these patterns.

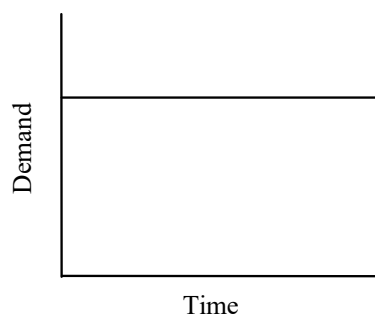


Fig 5.1A Horizontal Pattern

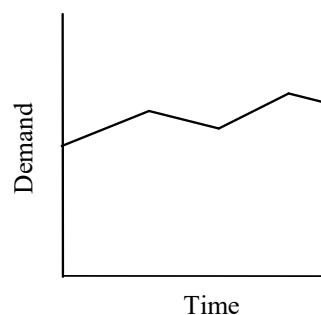
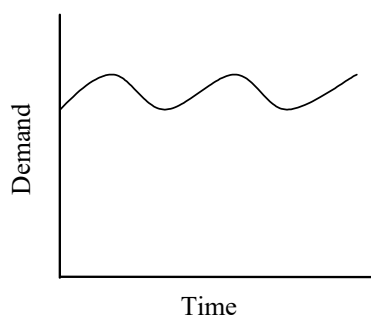
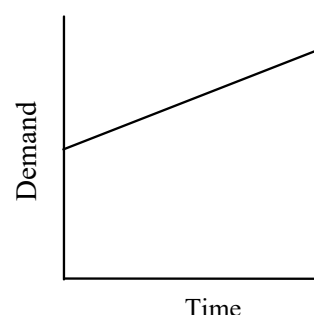


Fig 5.1B Seasonal Pattern

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**Fig 5.1C** Cyclical Pattern**Fig 5.1D** Growth Pattern

A business cycle shows a cyclical pattern but over a long time. Note that the business cycle passes through four stages, namely recession (bottom of the curve), recovery (rising trend in the cycle), growth (or expansion) and decline (or contraction). Seasonal pattern is observed over a year. Therefore, it has quarterly or monthly variations in demand. A horizontal pattern indicates product maturity; whereas, if in a cyclical pattern, a long-term increasing trend is observed, it indicates the growth pattern. Timing of project is essential for ensuring better profitability. One of the following methods can be used for determining the pattern of past demand:

1. Mean
2. Naïve
3. Moving average
4. Exponential smoothing
5. Auto-regression/moving average
6. Regression (simple regression and multiple regression; linear and non-linear regression)

A simple arithmetic mean of the historical data can be taken as forecast for the next period, if a horizontal data pattern is observed. The naïve method of forecasting uses the most recently observed value as a forecast. This method, which suffers from the most apparent demerits, can be used for forecasting (or setting target for) say the sales in the next one week. The moving average method is more useful in forecasting for a short period. In the exponential smoothing method, exponentially decreasing weights are assigned to various observations so that the most recent values receive more weight than the older values. The auto-regressive moving average (ARMA) method adopts a procedure where along with past values and their weights, the past error in forecast (deviation of actual from forecast) is also weighed. Regression is also useful in time series analysis. For the time series analysis, a simple regression is normally used, either linear or non-linear.

(ii) **Causal model-based forecast:** Forecasting methods described in the previous section can be aptly applied if all factors influencing the demand remain constant during the forecast period; or if demand is purely the function of time. In many cases, the demand of a particular product can have explanatory factors. The behaviour of one or more factors may be responsible for change in demand. Many methods can be employed for forecasting the variable (demand) of such nature. Some of these methods are listed as follows:

- **Regression and correlation:** Regression techniques are more useful when one studies dependent variable (demand) in association with its causal (independent) variable. In causal-based regression, one may take other variations of regression analysis to make it more meaningful.
- **Coefficient of correlation:** The correlation coefficient (or coefficient of correlation or just correlation) is a calculated number, which indicates the degree to which two sets of numbers are statistically related.
- **Decomposition method:** The decomposition method attempts to explain the pattern or change in it with some factors responsible for the change. A pattern or change in it can be broken down (decomposed) into a few factors.
- **Input-output tables:** These tables use coefficients, which are assumed to remain constant: for example, savings rate and GNP growth relations are used in planned economies for preparing their annual plans. Such tables can be used for projections of demand of certain products.
- **Econometric models:** These are also developed for measuring the impact rate of change in the causal variable. Simple and multiple regression equations are a part of the econometric models.
- **Consumption level method:** Consumption level methods are useful for estimating the demand of consumer goods items. Demand of a particular product might be elastic to the income and/or price.
- **Consumption co-efficient (end-use) method:** This method is recommended for forecasting the demand of intermediate goods. Usually, intermediate goods have multiple end uses.
- **Leading indicator method:** This is a useful method where demand of a product follows a particular indicator but with a difference in timing. To avoid reliance on a single series, composites of many leading indicators are usually constructed.

Finally, one should remember that there is no foolproof method of forecasting demand without any error. Pattern and trend may change due to change in causal variables. Once the demand and supply are forecast and the gap is determined, the next decision is about the capacity of the proposed project.

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Check Your Progress

1. What is the aim of market analysis?
2. Differentiate between qualitative techniques and quantitative techniques.

5.3 MARKETING STRATEGIES

Marketing strategies are prepared by the senior marketing and sales personnel in consultation with all stakeholders and presented to the top management for approval. A marketing strategy is a subset of the overall corporate strategy and therefore has to be synchronized with it. Marketing strategy may be a brief document or an elaborate exercise depending on the nature of the company's business and the size of the company. It also depends on how seriously the business firm takes its annual marketing strategy exercise.

Each business unit, in a business firm with multiple business units, prepares its own independent marketing strategy. All of these individual strategies are eventually combined into the overall corporate strategy of the business firm. A marketing strategy often takes into account the learning and the experiences of the year(s) gone by. Often a company may prepare a rolling marketing strategy which means not only a precise marketing strategy for this year but also a blueprint for subsequent years. A marketing strategy or a plan is a meticulously researched and carefully arranged document that contains several sections and components. Preparing a marketing strategy requires effort, time and money. A good marketing strategy however is essential to the success of any business firm. A marketing strategy has several measurable periodic milestones against which periodically performances can be measured—either monthly or quarterly or both.

While the marketing strategy is a very comprehensive document, the parameters measured out are typically business numbers. These are:

- Order booking status
- Order execution backlog
- Invoicing—monthly, quarterly, year to date (cumulative)
- Collections—monthly, quarterly and year till date
- Bills receivables (customer outstanding)
- Bills payable
- Average receivable period
- Sales returns—absolute and percentage

Sometimes an outside consultant is also engaged to bring about a wider view to a marketing strategy as the external consultant brings about a freshness of approach

and new out-of-the-box ideas which may be missing from the marketing strategy prepared internally.

Marketing Feasibility

Components of Marketing Strategy

A marketing strategy is often an elaborate document. It may contain some or all of the following components:

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Environment scan

This is often an initial part of the market strategy. The current and ongoing business, economic, political and social environment (social environment is particularly relevant if the business firm produces fashion/lifestyle products) are presented and analysed from a point of the possible impact these may have on the marketing strategy and the products sale performance. The environment is important because most of the marketing activities, to a lesser or greater extent, are affected by the environment. For instance, if there is a deep economic recession, the marketing strategy will tend to be conservative. Similarly if a country is troubled with political uncertainties, the marketing manager will not make an aggressive marketing strategy. On the other hand, if a society is fashion conscious, the players in this business—apparel, cosmetics, shoes —will all have upbeat marketing projections.

Situational analysis

In this section of marketing strategy, the business firm will study and document the situation the business firm is presently in *vis-à-vis* the market it operates in. The questions asked are—How is the market growing? Wherein lays the opportunity? What are the past historical influences which are likely to have a bearing on the future business?

Some of the situations which can adversely affect the marketing/corporate strategy:

- **Ongoing IPR violation litigation:** This is often faced by drug companies.
- **Major tax notice and litigation:** Many Indian companies today are struggling with major tax claims as the way of tax calculation is always subject to interpretation.
- **Violation of work permits:** An IT outsourcing company may reduce its strategies if it faces major challenges in overseas markets like the USA over onsite work permits.
- **Top management/CEO transition:** This can have a profound effect on the overall morale, sentiment and business continuity. Recently, the CEO of a renowned firm was summarily dismissed owing to sexual harassment charges and the stocks of the firm fell by 10 per cent immediately.

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- **Strikes and lockouts:** Strikes and lockouts can play havoc with production and delivery schedules. It can lead to order cancellations and vendor unrest. It may also result in exodus among the managers if it continues for some time. In such times, the marketing strategy needs to be drastically pruned and made realistic.
- **Arson or accident in strategy:** This can again play havoc with sentiments, manufacturing and delivery schedules, and thus marketing strategy needs to be modified accordingly.
- **Natural calamities:** Natural calamities may affect business and marketing strategies. A tornado may snap off electricity lines and factory workers may not turn up for a week. These calamities need to be taken into account—particularly in the areas where these kinds of natural disasters happen more frequently.
- **Major shortfall of basic raw material:** Lack of raw materials may simply shut off a production unit, for instance, if raw alumina is not available, then an aluminum wires and sheets will be forced to reduce production or stop altogether till they find an alternative supplier who in most of the cases may not be as cheap as the previous one.

Such situational factors have to be mentioned first as their presence and their subsequent removal can dramatically alter marketing strategies.

Types of Marketing Strategies

Marketing strategies can be broadly classified in into four types. They are as follows:

1. Market Leader Strategies
2. Market Challenger Strategies
3. Market Follower Strategies
4. Market Nicher Strategies

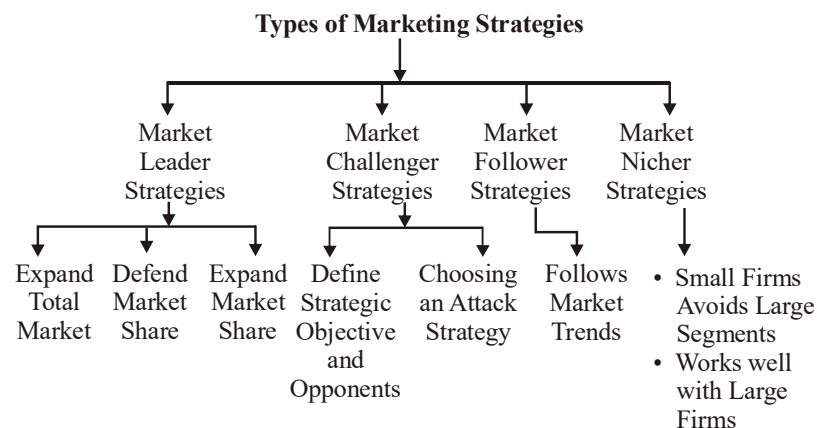


Fig. 5.2 Different Types Marketing Strategies

Key Inputs of a Marketing Strategy

Marketing Feasibility

Now assuming that there are no compelling situations which need to be taken into account, the typical inputs that go into making a marketing strategy include the following:

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1. The past sales records

- (i) Product wise sales records
- (ii) Quarter wise sales records (Q1, Q2, Q3 , Q4)
- (iii) Region wise sales records (East, West, North, South)
- (iv) Country wise sales records (in the case of a multinational operating in many countries)
- (v) Vertical wise sales records (i.e. healthcare, manufacturing, service industry, IT/ITES)
- (vi) Type of industry classification (enterprise, commercial, SOHO)
- (vii) Class of customers (corporate or retail)

2. The past profitability records

- (i) The data is analysed product wise.
- (ii) The data is studied region wise as well.

3. Sales turnover strategy in the coming year

- (i) The planner needs to take into account the past performance of the company.
- (ii) The planner needs to analyse the overall market scenario and sentiment in the market.

4. Gross margin

- (i) **Gross margin overall:** It is required to check the previous year gross margin and the expected margins.
- (ii) **Gross margin per product:** It is required to analyse the product wise profitability.

5. Sales force

- (i) Sales force structure and design should be checked.
- (ii) The territory coverage strategy should be developed by the sales force to ensure that the territory is properly covered.
- (iii) The target per sales executive should be reviewed every year.
- (iv) To ensure adequate coverage efficiency and maintain customer proximity, a business firm should reassess the optimal number of named accounts per sales person.

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- (v) Sales force salaries need to be reviewed and revised in order to keep pace with inflation and ensure competitive sales force salaries parity.
- (vi) The travelling and communication costs need to be kept optimal as it can easily get out of hand. This is also referred to in the industry as ‘Walking and Talking’ costs.
- (vii) The sales force size and structure needs to be reviewed in the marketing strategy exercise.

6. Advertisement and brand promotion

The following tasks are required to be performed:

- (i) Analysing previous years advertisement and promotion costs
- (ii) Analysing media efficiency
- (iii) Planning total advertisement and sales promotion budget for the coming year
- (iv) Studying the cost breakup between print and electronic advertising, sales promotion
- (v) Studying major campaigns past year and their effectiveness
- (vi) Studying the impact of celebrity endorsers, if employed
- (vii) Analysing cost versus benefit for each media vehicle
- (viii) Examining the value addition being done by celebrity endorsers
- (ix) Studying the impact, reach of online marketing being done by the business firm, steps to augment or increase it, if necessary

7. Dealer’s costs and margins

Some important questions:

- (i) Are dealer margins adequate?
- (ii) Are dealers happy with these dealer margins? Or is there dissatisfaction?
- (iii) Are the dealer commissions relevant in today’s context (based on also what competitors are offering as dealer margins)?
- (iv) Is a review required based on dealers’ feedback received last year?
- (v) Do these margins need to be modified or amended?
- (vi) If they are to be modified, what will be the impact on margins? What will be the impact of cost of sales?

Dealer special incentives

- Promos and incentives to be introduced in the current year so as to sustain dealers’ interest
- Dealers’ contests to be planned

Dealer management issues

- Major conflict issues both commercial issues and contractual issues
- Major flare-up last year. The types of flare up and conflicts that can appear are:
 - o Between dealer and management
 - o Between dealer and sales force
 - o Between dealer and dealer (horizontal conflict)
 - o Between dealer and its distributor (vertical conflict)
 - o Between dealer and another distributor (diagonal conflict)
- What kind of preventive measures are needed to be taken in order to reduce, manage and contain these conflicts?
- Is there a need to review dealer management structure?
- What are the major pain areas of dealers? The business firm may suggest some ways how to address them.
- Dealer get together need to be planned - 'Meet the Management' events. The venue, agenda, invitees, theme are all planned well in advance.
- What about quality of dealers? Do they need to be looked into? Are the dealers adequately trained in new age tools and methodology? Or are the majority of them they still very traditional and insist on submitting and receiving only paper documents?
- How to organize dealer trainings in order to bring them up to speed on company initiatives, new products and MIS tools and methodologies? Agenda and contents to be planned.
- Is the business firm proposing extension its IT network to its dealer network for more effective, efficient and faster information flow? If so, what is the strategy for the same?

NOTES**Dealer structure review**

- Is the dealer network structure adequate in today's context? Or does this structure need to be augmented or modified?
- Do the present control systems need to be enhanced or slackened?
- Any investments needed, for instance, a video management system (VMS) based channels systems?
- Is there a need to introduce company-owned show-rooms? Location, purpose, interoperability issues with present dealers in the same city

8. Products

Portfolio analysis: The marketing department analyzes the existing product portfolio thoroughly and does a Product Life Cycle (PLC) analysis.

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New products introduction strategy

- (i) Every year there must be some new product introductions to sustain interest and excitement among the sales force, dealers and customers. So it obtains new production release information from the product management group and plans a structured release.
- (ii) When to launch the new product(s)? The launch timing is important and is carefully chosen (depending on the region where it is to be launched).
- (iii) Marketing strategy for launch of new products—what shall be the ad copy, the theme, the USP, the communication mix.
- (iv) Test marketing has to be done first for launching every new product. This is typically done in 1 or 2 carefully chosen cities—typically these are non-metros.
- (v) After that a soft launch is done. This soft launch may be done in 1 or more states and for a limited duration.
- (vi) Finally, if results of both the test launch and the soft launch appear positive, the business firm feels confident to go in for a nationwide launch with proper campaign planning.

Products to be phased out in the coming year

- (i) The list of products to be phased out is made and announced through appropriate company communication.
- (ii) Exit strategy to be finalized—when to announce closure, when to announce closure of support period [typically support may continue for some-time even after end of sales (EOS).
- (iii) Against each phased-out product, a replacement strategy is to be made. How are existing customers to be handled if they want to place a repeat order?
- (iv) Support strategy, if any, required for products that need support even after EOS (end of sale). Typically support is scaled down progressively so as not to cause inconvenience for regular existing customers.

Pricing and price sensitivity

- (i) How realistic are the product pricing based on competitive pricing strategies?
- (ii) How is the price sensitivity? What is likely to be the impact on sales volumes if prices are increased or decreased?
- (iii) Are the products easily replaceable by competitor's products if prices are raised?

Support Staff

The support staff in a sales and marketing department includes those who are not directly involved with sales but are equally important as each of them performs a key function. They are sales coordinators, marketing team members, the brand manager, dispatch and logistics personnel, stores and dispatch personnel, etc. A proper audit is done as these people do not directly generate revenue so the business unit will try to keep only the optimal level of staff required for the above functions. The questions that are typically looked into are:

- Any additions/deletion/rationalization required?
- What are the interoperability issues?
- What are the reporting issues?
- Can certain functions be combined—carried out by the same person—in order to reduce costs?
- Can certain resources be shared, i.e., between two business units in order to reduce costs?

Marketing strategy of a business firm

The marketing strategy forms a subset of an overall company strategy. The marketing strategy is influenced by and influences in turn the following corporate functions

- Hiring and training strategy
- R&D strategy for new products
- Expansion /modernization of the production facility
- Financial strategy- capex, opex, cash flows

Presentation of the Marketing Strategy

The following are the common consideration in presenting a marketing strategy:

- Typically this is an annual exercise.
- A marketing strategy prepared by a business unit of the business firm may be placed by the marketing manager in front of the sales team as well as the corporate manager in an event at or around the time of the year closing.
- This formal structured event may last one or two days. This event is often conducted outside the office—typically at a resort or a hotel. This is done to ensure that the attendees are free from their day-to-day office work in order to focus on this event.
- This presentation is done by several speakers and is usually in the form of power point presentations. These presentations often comprise easy-on-the eyes bar diagrams, pie charts, etc.
- Intense discussions take place on the various points as they are presented.

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- Sometimes the respective sales heads, say the regional or individual sales managers are asked to present their respective parts and be ready to defend the figures and data presented.
- Once it is accepted by the management the marketing strategy then becomes the operating guidelines for the coming year for the marketing activities.
- The marketing strategy or relevant sections thereof is shared between all stakeholders.
- The marketing strategy is a controlled document and is never shared with anyone other than the close group for who it is meant.
- This event often gives a chance for sales managers to meet and interact with the senior management staff in an informal atmosphere.

Periodic Reviews of the Marketing Strategy

There are frequent reviews which take place to check if the market strategy is on course. The periodicity and the things to be reviewed are often stated in the marketing strategy and agreed upon in the strategy presentation. These are:

1. **Monthly reviews:** This is usually done at a local level, say, between each manager and his direct sales team. The primary focus is on month to month numbers and the challenges the sales force may be facing in getting business.
2. **Quarterly reviews:** Quarterly reviews are also commonly held to review progress of the marketing strategy. It usually involves the marketing management team.
3. **Half-yearly reviews:** Here, the senior corporate management may join.
4. **Unscheduled reviews:** An unscheduled or an emergency review meeting may take place if things are completely out of line with those that were projected at the beginning of the year. Sometimes it may happen if there is a serious complains from a major customer. In such a case the corporate management may seek an unscheduled emergency review.

Main Phases or Steps in Marketing Strategy

A marketing strategy is developed through three main phases: Segmentation, targeting and positioning.

1. Segmentation

For a market with huge numbers of customers, a firm must understand and identify its potential customers. A company is unable to serve all the customers who are usually diverse in their buying habits and requirements. As they are numerous in number, a company needs to identify the market segment it can serve effectively. As products are launched, companies have to select the right market segment for

them, decide on the target market and position the product properly. The basis for this segmentation can be any one of the following:

- (i) **Demography:** The factors like population mix, gender ratio, lifestyle and cultural values fall under demography. Companies may focus on the demography of a market before launching their product or choosing it as their target market.
- (ii) **Geography:** Geography means the location of the market and the natural factors affecting it. Climatic conditions, terrain, seasonal weather pattern, occurrence of natural calamities, etc., are taken into consideration while planning and choosing a market.
- (iii) **User preference and buying pattern:** Another important point which is taken into consideration for segmentation is the user preference and their buying pattern. For example, the strategies of promotion and delivery of product is different in rural areas from urban areas due to the difference in the buying pattern of the rural people. Rural people do not impulsive purchasing indulge in, neither do they buy things in bulk which is unlike the behaviour of urban consumers.
- (iv) **Benefit sought:** One important thing which a firm matches while choosing the market segment is the benefit which is expected by the customers of that particular segment from the promised product and the benefit which is provided by the firm through its product. The firm seeks to meet the customers' expectations with its promises. The firm thus decides to choose a particular segment. The firm chooses the sector for which it can cater to comfortably, thereby fulfilling the customers' expectations.
- (v) **Psychographic lifestyle:** Lifestyle plays an important role in choosing the market segment. Firms analyse the psychographic lifestyle of a particular segment and make strategic marketing decisions accordingly.

A market segment thus consists of a group of customers who share a similar set of wants. The marketing strategy of a firm helps it to identify the most effective and appropriate market segment that should be targeted. While making its strategy, a firm must keep in mind the difference between a segment and a sector. A segment is always decided on the basis of a similar set of wants and a sector is grouped according to the income group, age, gender, etc. Understanding the market segment helps the firm to formulate a marketing strategy according to its competitors, taking into account the most effective distribution and communication channels.

2. Targeting

Marketers have to decide which market they want to sell their products in and these become the targets for the firm. Once the firm identifies its market segment, it formulates its strategy and decides the number of segments to be targeted. Markets can be based on different age groups, religious denominations, people

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market, need-based markets, etc. It is the firm that decides whether to go for single-segment focused marketing, selective specialization marketing, undifferentiated marketing or mega marketing. *Mega marketing* is the strategic coordination of economic, psychological, political and public relations skills, which are employed to gain the cooperation of a number of parties in order to enter or operate in a given market. Markets thus can be targeted at the following four levels:

- Segments
- Niches
- Local areas
- Individuals

One more responsibility lies with the firm while choosing its target market and that is to be socially responsible while making the choice. Corporate social responsibility (CSR) is now used to create brands and even acts as a promotional tool. It strengthens the brand and provides a feel-good factor for its stakeholders. Many companies like Tata, Wipro, Infosys, Aditya Birla Group in India and IBM, PepsiCo and Coke worldwide are engaged with many social causes.

3. Positioning

‘Positioning is the act of placing the product in the mind of the prospect.’

According to Philips Kotler, the three strategic marketing steps which can be taken by a firm to build its position in the minds of the prospective customers are:

- (i) Strengthening the current position of the firm in the minds of the customers, e.g. 7Up advertised itself as the ‘Uncola’ drink.
- (ii) Grabbing the unoccupied position. SBI, noting that a foreign bank provides many more facilities to the Indian customer, positioned itself as the provider of ‘pure banking’.
- (iii) Deposition or reposition the competition in the customers mind.
- (iv) Exclusive-club strategy implying that the product is one of the best. The implication is that those in the club are the ‘best’. For example, ‘Mint’ of Hindustan Times states, ‘We are no. 2 Business Newspaper.’

Positioning can also be done based on the notion that there are three types of customers and so there are three different types of images that can be created for these individuals by the firm. These three images are as follows:

- (i) **Strategy to be known as product leader:** Some customers favour the firm that is leader either in cost, technology or any other parameter. Many firms that are leaders try to position and consolidate their image as the mater brand in the minds of customers.
- (ii) **Strategy to be known as the operational leader:** Some customers need highly reliable and quality products. Hence, firms like Dell try to position

themselves as operationally excellent producers. Dell works on its R&D and positions itself as the most excellent producer of laptops and PCs in the world.

- (iii) **Strategy to be known as customer-intimate firm:** Some customers demand high responsiveness in meeting their individual needs and thus look for companies which are customer orientated and intimate.

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5.3.1 Specialist Roles Open to Market Nichers

A niche market is the subset of the market on which a specific product is focused. The market niche defines the product features aimed at satisfying specific market needs, as well as the price range, production quality and the demographics that it is intended to target. It is also a small market segment. Not every product can be defined by its market niche. The niche market is highly specialized, and aiming to survive among the competition from numerous super companies. Instead of marketing to everyone who could benefit from a product or service, a niche marketing strategy focuses exclusively on one group-a niche market-or demographic of potential customers who would most benefit from the offerings.

Check Your Progress

3. What are the four types of marketing strategies?
4. When is an unscheduled review done?
5. What is the benefit of corporate social responsibility?
6. Define positioning.

5.4 FINANCIAL AND ECONOMIC FEASIBILITY

As mentioned under Phases of Feasibility Study, the financial feasibility check involves a detailed financial analysis. Financial analysis includes quite a few assumptions and calculations. Some are briefly described below:

Estimates

Projections are made for price of product, the cost of various resources required for manufacturing goods and capacity utilization. Use of the thumb rule or actual data of some comparable projects are generally included in the estimates.

Period of analysis

The period of estimate is determined and the terminal value of the project is forecast. The period of estimate should be justified by factors like, the product life cycle, business cycle, ability to forecast, period of debt funds, etc.

NOTES**Financing alternatives**

Financing alternatives are considered and a tentative choice of financing mix is made together with assumptions regarding the cost of funds and repayment schedules.

Basic working

Based on assumptions and estimates, some schedules are prepared. Some of the schedules made for this purpose include:

- Debt servicing schedule (interest payment and principal repayment schedule)
- Working capital schedule
- Working financing schedule (working capital loan, interest and repayment schedule)
- Depreciation schedule for income tax purpose
- Depreciation schedule for the purpose of reporting under Companies Act, 2013 (if depreciation policy is different from income tax rules)
- Schedule of cash flow from operations
- Project cash flow schedule

Bottom-line effect

All assumptions and schedules are translated into the bottom-line financial statements, which include projected income statements, projected balance sheets and projected cash flow statements. The projected income statements indicate the year-wise and average profit during the project life, the projected balance sheets show the financial position of the firm over the period of project analysis and the projected cash flow statements show the cash position over the time. Usually, all the bottom-line statements are prepared for business as a whole and projected cash flow statement is prepared on incremental basis.

Financial indicators

Based on the projected financial statements, some important financial indicators are calculated for a quick viability check. The important financial indicators are: Interest cover ratio, debt-service coverage ratio, payback period, net present value and internal rate of return.

Risk assessment

Basic indicators of financial viability use profits and cash flow estimates. They are based on a single point forecast value. They may be subject to risk or uncertainty. It is desirable to conduct a limited study of potential risk at the project feasibility stage. A preliminary assessment of risk is adequate at this point. Mainly two methods are applied at the feasibility stage—breakeven point and sensitivity analysis. The

accounting break-even point is calculated and compared with achievable capacity utilization. The difference indicates the safety margin. Sensitivity analysis is another technique of risk analysis. In sensitivity analysis, the effect of change in a single factor on the profitability is measured. This shows the variability in profit due to change in a factor.

Economic Viability

The terms ‘economic viability’ and ‘financial viability’ are not different for companies. However, from the national angle and from the viewpoint of the economy as a whole, economic feasibility and financial feasibility are not considered to be the same. Costs and benefits to the nation due to the proposed project are considered in the economic feasibility test. Tax revenue, generation of employment, savings of foreign exchange and such other factors differentiate economic viability from financial viability. The government and government agencies calculate the economic indicators of a project before permitting the project or financing it. This involves the calculation of the economic cash flow from the project, and then the calculation of the economic rate of return. The projects with very high ERR deserve special incentives and the projects that eat up valuable economic resources deserve disincentives. The social cost-benefit analysis (SCBA) is a further extension of economic cost-benefit analysis. Many financial and economic cash flows do not account for social good largely because they are not quantifiable. SCBA adopts a defined method of quantifying those non-quantifiable variables and finally calculates the social rate of return.

Check Your Progress

7. What are the factors which should justify the period of estimate?
8. Mention some of the financial indicators calculated for a quick viability check.

5.5 CLASSIFICATION OF SOURCES OF FINANCE

In general, projects accumulate their non-distributed profits as reserves. These reserves are the internal sources to projects for meeting their financial needs in times of expansion or diversification. Retained profit can be used by a company after a few years of operation – when the company starts making profits (whereas, companies usually break-even in the first year and make profit later). If a business has had a successful trading year with enough profits to pay all its expenses, a part of that profit could be used by it for financing its future dealings. Using the accumulated reserves for long-term finance is the best policy for any project because the cost of capital is almost zero, and no mortgages on assets are required. Reduction of cost and sale of assets are also internal sources to help the firm meet its financial requirements.

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However, reserves are not always enough to satisfy financial needs. Sometimes, reserves may be exhausted. So projects should tap the external sources of finance, though it may have an impact on the cost of capital. Nowadays, there are many sources of finance for meeting the financial requirements of projects. Sources of finance are categorized as internal sources and external sources.

1. Internal Sources of Finance

Using internal sources of finance is called purchase from internal financial statement. However, the easiest type of funding is using internal funds such as cumulative reservoirs. It is usual to compare the investment against the following:

- Allocation of reserve funds for paying off the company's debt
- Opposing calls on funds, counting calls such as the calls on growing plant capacity as well

It is essential to always spend a portion of the internal sources on the project, if only at the time of the initial appraisal, for convincing the external bodies as well as the senior management of the proposed investment's worth.

The internal sources include:

(i) Controlling working capital

The money invested in current assets like raw material, finished goods and debtors etc. is working capital. In other words, money required for day-to-day operations of business/project/enterprise is called 'working capital'. The entrepreneur can keep a control on the working capital by prudently judging the requirements for day-to-day operations. This he learns with experience and hence the entrepreneur would be able to use this method after some time when the business gets established. Reducing costs, delaying outflows and speeding up inflows are some of the techniques applied from time to time to control working capital.

(ii) Sale of assets

New activities can be financed by a business or the debts paid off of assets such as vehicles, machinery, furniture and fittings, and property are sold off. This frequently works as a source of short-term finance (for example, a vehicle being sold for paying off debts); however, if the assets that are being sold have a high value (for example, building or land), even long-term finance could be provided by it. In case the assets of a business are to be used, the option of 'sale and lease back' may be considered, under which the assets are sold and then rented and hired from the new owner of the assets. This could involve the payment of more money in the long-term but locked up cash can be liberated by this form of finance in the short run for tiding over crises.

(iii) Owner's savings

Owner's personal savings apply more to sole traders and partnership firms than to any other form of business. Owners might sometimes wish to invest a part of their own money as capital in the business. Owners' personal saving investment may be to meet the short-or long-term needs of the organization. The amount of the owner's savings availability depends on the amount that is invested as well as the decisions made by the individual making use of his savings.

(iv) Reducing stock

One of the assets that a business can use for raising finance is stock, which consists of unsold finished goods, semi-finished goods and the raw material that the business holds. Some stock that can be put to use in the event of an unanticipated hike in market demand is usually held by a business. Stock levels have a tendency of rising at the time of recessions or economic slowdowns, because goods pile-up as a result of not being sold. This does not generally offer vast amounts of finance—huge stockpiles in a business are indicative of lack of demand for the product so that it becomes difficult to reduce the stock. It is seen by some as a source of short-term finance.

(v) Trade credit

In a business, things are usually not paid for prior to taking possession of them. Rather, orders are placed for inputs/supplies and payment is made after the receipt of the items. It is advisable to make the payment in good time (within a month or so) as this helps the business in developing good relations with the supplier. In the balance sheet, this source of finance makes its appearance as trade credit. Such a technique of deferral of payment to some future period is a type of very short-term borrowing and aids in resolving cash-cycle problems.

(vi) Promoter's contribution

This is the first external source of finance for the project. The promoter brings his share of capital into the organization as seed capital to meet the start up expenses of the project. Financial institutions, investors and lenders want to know the promoters contribution in the project, before they take a decision on investment or lending loan. Promoter contribution is required in some cases of assistance such as grants and subsidies from government for a project.

2. External Sources of Finance

The following are the external sources of finance:

(i) Equity finance

In joint stock companies, equity finance is one of the main types of finance in the capital structure. Equity finance means raising the capital by shares issue. It is the

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main element of capital structure by way of representing the investment on the project's promoters' behalf, and generally comes from individual investors, firms engaged in project promotion through sponsoring the project, manufacture of equipment and machinery, and from institutional investors such as energy investment funds that are expected to have some form of capital stake in the project or insurance companies.

Equity differs from debt. The profits earned on the project are received by equity. Based on the performance of the project, the share of profit to equity is influenced. For example, in case a project does well, there may be a considerable equity pay out, but in the case of underperformance or bankruptcy, banks and other claims are paid first and only then are the equity investors paid. Therefore, a higher degree of risk is associated with equity, but at the same time, higher returns can be earned by it as compensation.

Debt providers normally expect the project to be at least partly financed through equity fund. In the case of a project that is well understood and carries a relatively lower degree of risk, the equity stake may be as low as 30 per cent, whereas in a project that is not understood all that well and consequently carries a higher degree of risk, the equity stake that is needed could go up to more than 50 per cent of the total cost of the project. Borrowers of equity consider equity investment on the project as third party capital inputs (for example, in the form of capital subsidies and cash grants) or direct capital investment. Lenders of equity fund demand that borrowers of equity take an equity stake in their own right (for building their commitment to their stakeholding). In general practice, lenders of equity usually try to ensure that at least 20 per cent of the cost of the project is made available in the form of borrower equity.

(ii) Debentures

Debentures are certificates of loan agreements that are given under the company's stamp and that undertake to pay the principal amount as well as a fixed return (that is based on the rate of interest) to the debenture holder at the time of maturation of the debenture. In other words, debentures are a form of long-term loan that public limited companies may take for a large sum and repay over a period of many years. The usual practice is to borrow them from a specialist financial institution. They are defined as 'debt secured only by the debtor's earning power, not by a lien on any specific asset.'

Debentures are long-term instruments of debt that are utilized by big companies and governments and for obtaining funds. Except for the differing securitization conditions, they are quite similar to bonds. Debentures are generally unsecured as there is an absence of pledges or liens on certain assets. However, they are secured by all the properties that are not pledged otherwise. In the event of the company going bankrupt, debenture holders are treated at par with general creditors. In the case of debentures, the issuer enjoys the benefit of having certain assets left free of

any burden so that they can be used as a source of finance later. A debenture holder can usually freely transfer the debentures held by him. Voting rights are not given to debenture holders and the interest they receive is charged against profits.

(iii) Debt finance

It is one of the chief types of finance, essentially required to build an optimum capital structure. Debt finance means borrowing loans from commercial banks, financial institutions and money lenders for a period of time on fixed rates of interest. Debt finance normally refers to a conservative commercial bank loan. In certain situations, a project may get debt from institutional investors i.e. insurance companies. An interest (or cost of the debt) is paid by borrowers of debt finance and the principal amount is repaid by them at the end of the loan period. A pre-decided interest rate is charged by lenders of debt finance that is set through the addition of an 'interest margin' to the standard inter-bank lending rate of the bank. It is normal practice to express the interest margin in 'basis points' that are representative of the bank's income or return on investment. Most countries are now considering interest payments on debt as a tax deductible source of expenditure, which is why debt is considered 'less expensive' than equity.

In debt finance, no share is possessed by the lender in the project and hence no 'upside' potential is available for him. This means that he is not considered for project sharing. By 'upside' it is meant that if a project performs soundly, profit as well as cash for the equity investors would increase. In debt finance, the lender gets a constant interest amount on his loan and regardless of how good the performance of the project is, he never receives anything beyond the principal repayment and the interest. However, if the project does not perform well, the lender stands the risk of encountering a 100 per cent loss on the loan extended to the project. Lenders have little or no opportunities for increasing their returns along with facing the probability of standing to lose their whole investment. Therefore, they concentrate on all the aspects of risk in order to minimize the risk that has to be borne by everyone who is party to it.

(iv) Bonds

Bonds are a type of debt. They are generally issued to meet long-term financial needs of a project; this means that bonds are liable to be long-term obligations that have fixed repayment schedules and rates of interest. Governments, companies or firms issue bonds as interest-bearing instruments and sell them to investors in order to raise capital fund. They are typically issued and sold in the public bond markets, though an increasing number of them are now being directly sold to institutional investors (this is called 'private placement').

Credit rating agencies are responsible for awarding ratings to certain private issues and public bonds. They use diverse nomenclatures, with AAA or AA+ generally being the top investment grade in bond rating and BBB—being the worst. So long as an investment grade credit rating can be achieved, there are

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certain advantages that bond issues enjoy over bank debt. One of these is that they may serve as sources of long-term finance, and at times, might even enjoy superior commercial terms but they have lesser flexibility than bank financing. Additionally, in the case of projects that are undertaken in developing or what are considered riskier countries, the host country's investment rating affects the credit rating.

(v) Grants

A grant is a non-returnable source of funding that is offered to exporters or for covering capital costs. Governments as well as local bodies that are interested in developing the projects, persuade developers to contemplate considering projects that carry a higher degree of risk along with indeterminate returns by means of grants, because of the location factor and to fulfill the responsibility of balanced regional development. It is possible to utilize grants for reducing the risk of investors as well as commercial lenders, or for covering the incremental capital costs. It is necessary to operate grant programmes with caution, in such a manner that the market forces are not deformed and the market does not collapse on their being withdrawn. Usually, lenders accept between 30 and 50 per cent of a project's total equity requirement through grants.

Government grants are usually offered for particular projects that are instrumental in benefiting or sustaining the environment in some way or aid the disadvantaged minority segments or make a contribution towards regenerating underprivileged sections. If a person is disadvantaged in any way, either physically or due to their background, then charitable associations and other such establishments may be sought for the grant of money for that particular project.

The advantages of grants are as follows:

- There is adequate grant money available for ventures undertaken by disadvantaged minorities or for projects that make an active contribution to the environment or the community.
- Nothing is repaid by the entrepreneur.

The disadvantages of grants are:

- The usual practice is to offer grants for particular ventures, with the result that entrepreneurs may not be able to raise all the money required for a start-up project.
- Some strings are always attached. Entrepreneurs receive the money on the grounds that they spend it on certain items only.
- Not many businesses qualify for grant money.

(vi) Factoring Services

Factoring services are short-term sources of finance to provide working capital needs of a project. Factoring services relieve the project promoter from the tension

of delay from debtors and from meeting the creditor's demand of payment. A factoring company provides services by charging a nominal amount from project promoters for handling the process of debt collection. Most of the value of the debt is first paid by it to the business, following which money is collected from the debtor.

(vii) Banks

Banks are one of the important sources of finance to meet short-term financial requirements, such as the working capital for tiny, ancillary, small scale sectors. To get a short-term loan, the entrepreneur should first visit the bank branch with which he has an ongoing relationship because the banker can easily assess his requirements and get an idea about his business operation. Hence, he can get the loan at the right time. As far as mainstream investments that are a part of his normal operations are concerned, the bank would already be aware of them and might even deal in the types of investment required by the entrepreneur. For instance, in the case of unusual proposals that either carry a high degree of risk, or involve huge sums of money or novel technologies, the bank may still be in a position to assist the entrepreneur, either functioning through its own branch organization or collaborating with the entrepreneur as other financial institutions are approached. In a number of instances, only simple technical and financial appraisals are needed. The interest rate that would be levied on the entrepreneur for the loan would be dependent on the type and size of the loan, the borrower's financial strength, the level of risk associated with the loan and the prime central bank rates.

(viii) Insurance and Guarantees

Insurance and loan guarantees are fundamental constituents of financing. It is a general practice to put in place full insurance packages prior to finalizing the financing on a project. In the case of project work involving foreign assignment and technical intervention, insurance should be in a position to satisfy technology insurance that deals with the risks that are specific to the performance of the technology as well as export insurance that deals with the risks specific to engaging in business in other countries.

Export insurers usually provide a variety of appropriate insurance covers (e.g., Export Credit Agencies or ECAs, along with their counterparts in the private sector) for meeting foreign business requirements. Loan guarantees carry extreme significance, especially for project financing. ECAs furnish the insurance cover for loans, and guarantee to pay the exporter from the loan and also guarantee the loan value to the bank in case of default due to commercial or political risks. Loan guarantees are frequently considered to be essential prerequisites by banks if they are to extend a loan for a project.

Technology insurance is vital for the new generation of technologies (e.g., renewable technology). Lenders need to exercise caution while dealing

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with technological risks, particularly in the case of novel technologies or newer application of older technologies. For technological risk to be covered, bonds or performance guarantees are frequently provided by manufacturers. In the event of the manufacturer not being a huge creditworthy organization, further support may be needed from bank guarantees or commercial insurance policies.

Check Your Progress 9. What are debentures? 10. What are the advantages of grants?
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5.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Market analysis aims at assessing the potential sales revenue from the proposed project.
2. While quantitative techniques find solution directly based on historical data, Qualitative techniques aim at forecasting changes in a basic pattern. Qualitative techniques are used for forecasting a turning point in the pattern: for example, forecasting an expected decline in the demand of a product, which has touched the maturity point.
3. Marketing strategies can be broadly classified in into four types. They are as follows:
 - i. Market Leader Strategies
 - ii. Market Challenger Strategies
 - iii. Market Follower Strategies
 - iv. Market Nicher Strategies
4. An unscheduled or an emergency review meeting may take place if things are completely out of line with those that were projected at the beginning of the year. Sometimes it may happen if there is a serious complains from a major customer. In such a case the corporate management may seek an unscheduled emergency review.
5. Corporate social responsibility (CSR) is now used to create brands and even act as a promotional tool. It strengthens the brand and provides a feel-good factor for its stakeholders.
6. Positioning is the act of placing the product in the mind of the prospect.
7. The period of estimate should be justified by factors like, the product life cycle, business cycle, ability to forecast, period of debt funds, etc.

8. Some important financial indicators calculated for a quick viability check include Interest cover ratio, debt-service coverage ratio, payback period, net present value and internal rate of return.
9. Debentures are certificates of loan agreements that are given under the company's stamp and that undertake to pay the principal amount as well as a fixed return (that is based on the rate of interest) to the debenture holder at the time of maturation of the debenture.
10. The advantages of grants are as follows:
 - There is adequate grant money available for ventures undertaken by disadvantaged minorities or for projects that make an active contribution to the environment or the community.
 - Nothing is repaid by the entrepreneur.

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5.7 SUMMARY

- Approach for conducting market-feasibility study would vary depending upon the type of the proposed product. In case of a novel product idea, market-feasibility check has to be based on absurd judgement and wishful thinking. If a proposed product is new in an economy, and is marketed successfully in some other economy, its market feasibility is assessed through a meaningful comparison of some broad economic and cultural indicators in two economies.
- Business managers are expected to know and apply the forecasting techniques in their decision-making process. These techniques can be separated in two broad classes, namely, quantitative techniques and qualitative techniques.
- Forecast is divided into two points— pattern-based forecast and causal model-based forecast.
- There is no foolproof method of forecasting demand without any error. Pattern and trend may change due to change in causal variables. Once the demand and supply are forecast and the gap is determined, the next decision is about the capacity of the proposed project.
- Marketing strategies are prepared by the senior marketing and sales personnel in consultation with all stakeholders and presented to the top management for approval. A marketing strategy is a subset of the overall corporate strategy and therefore has to be synchronized with it.
- A marketing strategy or a plan is a meticulously researched and carefully arranged document that contains several sections and components. Preparing a marketing strategy requires effort, time and money. It may contain an environmental scan and a situational analysis.

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- Marketing strategies can be broadly classified into four types. They are as follows:
 - i. Market Leader Strategies
 - ii. Market Challenger Strategies
 - iii. Market Follower Strategies
 - iv. Market Nicher Strategies
- The inputs that go into making a marketing strategy are the past sales record, past profitability record, sales turnover strategy for the coming year, gross margin, sales force, advertisement and brand promotion, dealer's cost and margins, and products.
- The marketing strategy forms a subset of an overall company strategy. The marketing strategy is influenced by and influences in turn the following corporate functions
 - i. Hiring and training strategy
 - ii. R&D strategy for new products
 - iii. Expansion /modernization of the production facility
 - iv. Financial strategy- capex, opex, cash flows
- There are frequent reviews which take place to check if the market strategy is on course. The periodicity and the things to be reviewed are often stated in the marketing strategy and agreed upon in the strategy presentation. These are monthly reviews, quarterly reviews, half-yearly reviews and unscheduled reviews.
- A marketing strategy is developed through three main phases: Segmentation, targeting and positioning.
- A market segment consists of a group of customers who share a similar set of wants. The marketing strategy of a firm helps it to identify the most effective and appropriate market segment that should be targeted.
- Marketers have to decide which market they want to sell their products in and these become the targets for the firm. Once the firm identifies its market segment, it formulates its strategy and decides the number of segments to be targeted.
- 'Positioning is the act of placing the product in the mind of the prospect.'
- A niche market is the subset of the market on which a specific product is focused. The niche market is highly specialized, and aiming to survive among the competition from numerous super companies. Instead of marketing to everyone who could benefit from a product or service, a niche marketing strategy focuses exclusively on one group-a niche market-

or demographic of potential customers who would most benefit from the offerings.

- Before any financial analysis is carried out, some basic decisions must be in place. These basic decisions include a tentative choice of financing mix, cut-off decision and choice of evaluation techniques.
- Sources of finance are categorized as internal sources and external sources. The internal sources can be working capital, sale of assets, owner's personal savings, stock, and trade credit.
- The external sources are equity finance, debentures, debt finance, bonds, grants, factoring services, banks, insurance and guarantees, and venture capital.

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5.8 KEY WORDS

- **Market segment:** It refers to a group of customers who share a similar set of wants.
- **Mega marketing:** It is the strategic coordination of economic, psychological, political and public relations skills, which are employed to gain the cooperation of a number of parties in order to enter or operate in a given market
- **Niche market:** It is the subset of the market on which a specific product is focused. The niche market is highly specialized, and aiming to survive among the competition from numerous super companies.
- **Grant:** It is a non-returnable source of funding that is offered to exporters or for covering capital costs.

5.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on market feasibility.
2. What are the situation factors that should be considered while preparing a marketing strategy?

Long-Answer Questions

1. Discuss in detail pattern-based forecast and causal model-based forecast.
2. Examine the three phases of a marketing strategy.
3. Discuss in detail the internal sources of finance.

5.10 FURTHER READINGS

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Technical and Locational Feasibility

- 6.0 Introduction
- 6.1 Objectives
- 6.2 Technical Analysis
- 6.3 Locational Feasibility
 - 6.3.1 Selection of Site
- 6.4 Plant Layout
 - 6.4.1 Techniques and Types of Layout Planning
 - 6.4.2 Size of the Business Firm
- 6.5 Answers to Check Your Progress Questions
- 6.6 Summary
- 6.7 Key Words
- 6.8 Self Assessment Questions and Exercises
- 6.9 Further Readings

- Understand the important aspects of technology analysis
- Explain the importance of industrial location selection
- Discuss in detail locational feasibility and the importance of plant layout
- Examine the impact of the size of the business on the profitability of the firm

6.2 TECHNICAL ANALYSIS

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As mentioned under Phases of Feasibility study in Unit 5, if there is an ample market demand and not enough supply, the focus should shift to technology. The following inquiries must be made with respect to technology analysis:

- Availability of commercially exploitable technology and its alternatives
- Transferability of those technologies
- Other inquiries about the technologies
 - Normal capacity utilization
 - Requirement of plant and equipment and fabrication facilities
 - Production process needed
 - Possible product mix
 - Possible alternate usage
 - Flexibility
 - Rate of change
 - Waste disposal
- Risk implications
- Resource availability

(i) Availability

A task force will search for technology for the operations required for running the project. If technology is available, commercial exploitability must be verified. If commercially available technology is available, then alternative technology and their sources are identified. One must also inquire whether any of the technologies is currently used by any business and study their experiences.

If technology is available, should we buy the latest technology or would some old one be fine? Usually, in a cheap labour economy, less than the latest technology works fine from the labour-to-capital ratio angle. However, the choice has to depend on the effects of technology on the desired quality of product and cost of product, verses investment needed in a given technology.

(ii) Transferability

The technology transfer issue has to be addressed in a dual fashion—(a) Whether the transfer of technology is possible from the political angle and (b) whether transfer of technology is possible from the operations (environment) angle.

Either because of import restrictions imposed by the government or because of export restrictions or economic sanctions imposed by an exporting nation, a

particular technology cannot be transferred. In today's World Trade Organization's regime, normally one cannot expect import restrictions (unless there is no political relationship between the two countries), but economic sanctions from the exporting nations are quite possible, making it impossible to transfer technology from one country to another. Sometimes, the technology owner may not be willing to transfer the technology.

If the technology is transferable from the political viewpoint, one needs to check whether the technology would work in the environment where it will be transferred. Technology is usually very sensitive to the environment or climate in which it is used. Success of technology depends on the temperature level, moisture level, quality of atmosphere, quality of material, method of work and skill of labour, power supply quality and a host of other variables, which may be unique for each user. Given these environmental factors, can a given technology be transferred with minimum difficulties? What kind of adjustment and modifications in the configurations would be warranted to make the technology work? Those modifications add to the project cost and sometimes, some modifications may not be feasible at all.

(iii) Other Inquiries

Numerous other inquiries are made regarding technology. The following are some of important points of inquiries:

Normal capacity utilization

Every technology has its own capacity and rate of normal utilization, needing the rest of the time for routine or preventive maintenance. In addition, a rated capacity is usually not available fully, depending upon the environment in which it is used. Capacity utilization has a direct impact on available production and cost of production. Therefore, an inquiry about a potential 'normal' capacity utilization of a given capacity assumes great importance.

Requirement of plant and equipment and fabrication facilities

Technology comes with knowledge. However, machines for operations have to be fabricated separately. The following questions are essential:

- What type of plant, machines and equipment would be required for the operations?
- Are there machine fabricators who can make the required machines as per specifications?
- Can the fabricated machines be transported easily from the fabrication site to the project site?
- Can the required sequencing of processes, synchronization of machines and balancing of machines be attained?

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Production process needed

Efficiency of technology depends on process design. The following inquiry would be appropriate:

- What type of process design will be required?
- Can we build those processes in a desired sequence?
- If there are any site limitations (in terms of size and existing design of building, etc.) can the required processes be arranged with or without modifications?
- Whether the company currently has one or more of the processes required in the new technology and if yes, can we use the same with expanded capacity?

Possible product mix

A project may involve production of goods and services in a particular range and therefore, the technology and processes should be able to produce them in an appropriate mix.

Possible alternate usage

A technology that has an alternate use is better because if the company is not able to achieve its sales target, it can always change the product and establish in a different market. Many engineering firms enjoy the benefit of technology that has alternate uses. A company engaged in the business of manufacturing glass-lining equipment for chemical industry can use several of its processes to manufacture concrete-mixing machines.

Flexibility

This is the time of flexible manufacturing systems and the same is equally true for services operations. Customers' tastes change fast and the rate of change is becoming faster every day. If the product from the new project is closer to the consumer and has very little room for alternative use, then the processes must be flexible so that the firm can adapt to changes quickly. Usually, non-flexible machines and processes are cost effective for the production of the products, but face the danger of obsolescence if consumer taste changes. Thus, if the market analysis indicates shorter lifespan of demand of the current product and a potential change is envisaged, then one has to look for the technology, processes and machines that can easily adapt to the changes: for example, in the world-recessionary situation of the year 2008, Nissan Motors shifted its sizeable operations to Japan, because their plant in Japan is capable of producing sixty different models of passenger cars.

Rate of change

It is important to know and estimate the rate of change in technology. For example, information technology changes fast, requiring firms to buy latest technology as far

as possible. In general, the rate of change in technology is expected to be faster in a developed economy with respect to consumer goods, but technologies for producing intermediate products (steel, aluminium, etc.) that are away from the consumers are less likely to change at a faster pace. A business should be able to recoup the investment in any technology before the technology becomes obsolete for its current use.

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Waste disposal problems

Waste disposal is a legal as well as a moral issue. Some technologies have the problem of waste disposal and may be proved costly: for example, nuclear power plants suffer with waste disposal problems. Several countries that have been using nuclear power plants have not found effective ways of waste disposal; some others have not been conscious about this issue yet and create unimaginable problems for future generations.

(iv) Resource Availability

Can we have access to the required quality of resources needed by the selected technology? For example, a cold-roll mill (CRM) technology in the steel industry requires high quality coal with low moisture content and high carbon content. Long-term access to coal mines that have large reserves of coal at different levels of depth is essential. A task force may even consider visiting shortlisted coal mines, take samples from different depths and conduct lab tests to determine suitability of the coal for the technology being considered. Some technology may fail with poor quality of power supply and in some cases, highly-skilled workers may be needed, which may not be possible if the current workforce is low skilled and the relationship with unions is not good.

(v) Risk Implications

One would have noticed that the points we discussed so far in technology analysis essentially help in understanding and reducing risk. One aspect has been left out. Each technology has its own consequential fixed and variable costs during operations. A technology that ensues in high fixed cost but low variable cost creates a higher degree of operating leverage. A higher degree of operating leverage would enlarge the effect of change in sales revenue on operating profits. High degree of operating leverage is still good if demand is increasing, because increase in sales revenue will increase operating profit faster but if sales revenue declines, then operating profit will decline faster. Therefore, if there is any uncertainty about the sales revenue trend, then one must select a technology that has a low fixed cost even if its variable cost may be high. So, from among alternative technologies that are found appropriate from the analysis of all factors discussed so far, a company should select a

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technology that is appropriate from the angle of the degree of operating leverage or internal risk.

One must study the technology in such a way that simultaneous commercial exploitability of a technology, in the environment that can be created in the company, can be evaluated.

Check Your Progress

1. What are the environmental aspects of technology transfer that should be considered?
2. Give an example of a waste disposal problem that may prove to be costly.

6.3 LOCATIONAL FEASIBILITY

Location of facilities is a problem associated with the planning phase of a factory or even a service sector. Small entrepreneur to big industrial houses, hospital to a fashion designer shop or school to a five-star hotel, all start the first planning activity with questions—where to locate the site so that no change is needed for years to come. It is a very vital decision that has a long-term implication. We call this type of decision as strategic decision. It is not very easy to answer a location problem. The reasons are: (i) uncertainty in future, (ii) complexity and conflicting factors associated with the site selection problem, (iii) constraints and limitation of resources to produce a site, etc.

Factors Affecting Facility Location Planning

The factors, which affect the facility location decision, are:

- Raw material, workforce availability, transportation of raw material, availability of water and power, road-rails, etc.
- Nearness to market.
- Environmental factors, such as pollution, noise, etc., weather (in case of knitting industry), level of humidity and seasons, rainfall.
- Preference of executives or entrepreneur.
- Tax exemption, legal requirement, incentives, availability of loan/land, etc.
- Community culture and attribute, past history of industry located in the area, incidence of labour unrest in the area, political interference, etc.
- Cost of land, cost of transportation, wages of unskilled labour, etc.
- Location of other industries in the area, market forces for competition, etc.
- International consideration, room for expansion and growth, school, churches, medical facilities, recreational facilities, etc.

Apart from the above factors, many other factors also affect the location of facility. For example, if the raw material is quite bulky and difficult to transport, then the plant may be located nearer to raw material source. Many iron and steel industries are geographically located near the place where iron ores are found. Jamshedpur, Bokaro and Rourkela in India are places where iron ore is found. To run the power plant, coal is needed. Many NTPC power plants are located near places where coal is found. Similar observations are valid for oil fields and location of refineries. However, some other factors may have to be compromised.

Therefore, both urban and rural sites have their own strengths and weaknesses. A compromise could be the suburban site. These sites are located near the cities.

The analytical models can be solved using operations research techniques, such as simplex method or branch and bound techniques. There are many mathematical models available under facility location problems.

The p-median problem

Consider a connected network comprised of n nodes. In the most general form of p-median problem, each node represents both a place of demand and a potential facility site. The p-median model involves the location of p facilities on the network so that total weighted distance is minimized. It is assumed that each demand is served by their closest facility.

Facility Location Selection Problem:

Analytical Hierarchical Process (AHP) Approach

In the facility location selection problem, the decision maker has to prioritize or rank the available facilities and select the best one by meeting more than one criterion. In such situation, AHP—a MCDM—multi-criteria decision making tools can be successfully applied to select the location out of the available locations.

Weighted Ranking Method

There could be various qualitative factors that affect the facility location decision, which is difficult to quantify, such as acceptance of locating some facility by local people. In this situation, the facility location problems are solved using one technique, which is known as weighted ranking method, where decision is taken based on the weights assigned to each factor.

Simple Median Approach (SMA)

Many times the decision to locate facility is not simply to rank the locations out of the available locations but to identify the best location of new facility among the existing ones. In this situation, the coordinates of all existing facilities have to be

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measured and then the best possible location for new facility can be identified. One of the approach known as *simple median approach* can be applied to handle this problem.

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Break Even Analysis (BEA)

Break even analysis (BEA) computes the amount of goods required to be sold to just cover total cost spend in manufacturing the goods. It is also known as no profit, no loss point. BEA includes fixed costs and variable costs. The concept of BEA can be also applied for location analysis especially when the fixed cost and variable cost of each location are known.

Centre of Gravity Method (CGM)

Centre of gravity method (CGM) is another approach to optimally locate the location of new facility in order to optimize the weighted distance. In this method, the analyst or decision maker has to find the centre of gravity (CG) of the geographic area, where all existing facilities are located, being considered.

6.3.1 Selection of Site

The study of industrial locations forms an important part of an entrepreneur's jobs. Location of an industry can impact the profit, productivity and growth of the organization.

Ideal Location

Location selection can become a priority issue whenever

- A new enterprise is to be established.
- An established enterprise thinks about expansion, decentralization and diversification to meet the changing demand for its products.
- New branches are to be opened for increasing the volume of productions or distribution or both.
- An undesirable location is to be abandoned.
- The existing factory is not in a position to obtain renewal of lease.
- The tendency of shifting the market, depletion of raw materials, changes in transportation facilities, new processes requiring a different location are observed in a factory.

Selection of the Most Economic Site

The selection of an ideal enterprise location enables the enterprise to operate economically, smoothly, and efficiently. Several times, the location of an enterprise can influence the success or failure of that plant. While selecting a site, the owner must consider technical, commercial, and financial aspects.

Properties of a good enterprise location

- Nearness to market and nearness to raw materials
- Early availability of transport facility at cheaper rates
- Availability of skilled workers at cheaper rates
- Incentives/concessions for industrially backward areas
- Suitable land and building facilities

Steps in enterprise location

1. Selection of the region.
2. Selection of the locality or community.
3. Selection of the exact site.
4. Selection of the optimum site.

6.4 PLANT LAYOUT

In this section, we will discuss the meaning, characteristics, importance and functions of plant layout.

Need for Layout Planning

Once the facility location has been decided and land has been acquired, a sketch or plan is made to decide where each department/section, entrance and exit gates, restrooms, storage areas, etc., will be located. In the subsequent sections, we will see how this type of planning is done.

Definition of Layout Planning

We can define layout as, 'The physical location of the various departments/units of a facility within the premises of the facility.'

The departments must be located based on some consideration. The common considerations are -

1. Logical sequence of processing operation
2. Direction of material flow and material handling
3. Aesthetic considerations
4. Government regulations
5. Special requirements

The entrance and exit gates are usually critical in the layout planning of facilities.

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Objectives of a Plant Layout

Plant layout is the method to plan and arrange materials and facilities so that a steady flow of production is ensured at minimum cost. A good plant layout always results in comfort and satisfaction of workmen and this automatically increases the production. A bad plant layout leads to accidents and unnecessary problems.

A good plant layout is designed to achieve the following objectives:

1. Economic handling of materials and finished goods
2. Fast and efficient quality production
3. Enhanced utilization of available space
4. Flexibility in change of plant design and possibility of expansion at a later date
5. Improvement in work condition leading to higher productivity
6. Unidirectional/systematic flow of production operation
7. Reduction in waiting time
8. Reduction in manufacturing cost

Advantages of a Good Plant Layout

The advantages of a good plant layout are as follows:

1. **Production flow:** The prime concern of plant layout is smooth flow of the production function. Unhindered, steady, prompt and even work flow is a boom from good plant layout.
2. **Well-organized workspace:** A good plant layout means well-organized workspace with adequate facilities provided for the machines as well as for the workmen. Proper arrangement of machineries and tools eliminates congestion. The materials required are stored in their appropriate places so there is no confusion. Workmen are also distributed to their respective departments and there is no confusion in work.
3. **Better working conditions:** A good plant layout results in labour satisfaction due to improved and clean working conditions. It has been well-documented that motivation level increases when lighting and other aesthetics are improved. Safety of workmen is another important factor. A good plant layout ensures that the machine are properly placed, with adequate space in between so that there is no congestion and no danger of the workmen getting injured. This provides safety to the workmen and creates a good environment for work.
4. **Minimization of material handling costs:** A good plant layout minimizes material handling costs. The machinery and equipment are placed in such a manner that there is no difficulty in transferring materials between workstations. The provision of adequate material handling systems will

ensure that there is minimal labour cost, labour fatigue, etc., and labour can be utilized in productive jobs.

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5. **Minimization in damage and spoilage of material:** In a good plant layout, materials are handled properly which results in good quality of production. There is minimum damage and spoilage of materials. Minimizing waste also leads to increase in profits for a company.
6. **Flexibility in changing production conditions:** A good layout provides adequate space for future expansions, laying additional workstations, etc. The advantage is that in future if the market conditions change, the firm can easily put up new machinery, etc. without having to dismantle the existing ones and with minimum hindrance to the daily schedule or work.

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Types of Layout

There are four basic types of layout.

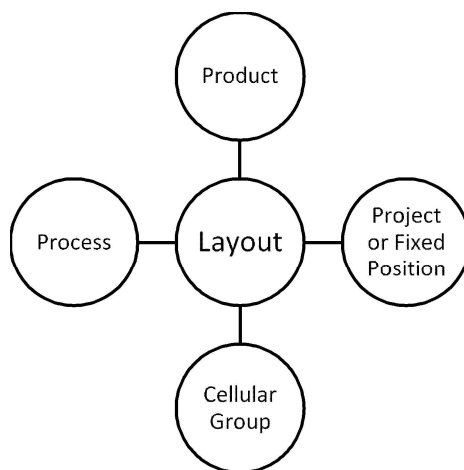


Fig. 6.1 Types of Layout

(i) Product layout

The placement of the equipment/machinery and materials in the order in which they are to be used for producing the product is called the product layout or line layout. This type of layout is found in industries where assembling of materials and parts takes place, such as the automobile industry. In such industries, the process starts with feeding in the raw materials and ends with the final product.

Advantages of product layout

1. There is low work in process since output of one stage is automatically the input of next stage
2. Material handling is less since the process is automatic.
3. Labour costs are less, as there is division of labour.

4. Quality control is easier to implement.
5. Easy and accurate scheduling of materials is possible.
6. Production control is simpler due to less product variety.

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Disadvantages of product layout

1. It is not easy to change the product – this will involve change in the layout and this is expensive and time consuming. So this layout is not very flexible.
2. If even one machine breaks down, the entire line will stop.
3. Expansion of work area or insertion of any machine in between other machines is not possible or is very difficult.

(ii) Process layout

The layout in which all the equipment/machineries performing similar tasks are grouped together is called the process layout or functional layout; for example, the milling machines can be grouped together to form one department and the grinding machines can be grouped together to form another department. Depending on their processing requirements, parts are moved in different sequences among departments. Dividing the whole work place into small units helps in faster production and better utilization of the work place. The process layout can give a higher variety of products; for example, in a garment plant the stitching machines are kept in one place, pressing machines such as irons in another, knitting machines in another and so on.

Advantages of process layout

1. Flexibility in adapting to changing volumes, changing varieties.
2. Helps workmen learn more skills as job rotation enriches their skills.
3. Problem in one machine does not affect other machines and production need not stop.
4. In case of future expansion or increase in varieties, the existing set up need not be pulled out.

Disadvantages of process layout

1. Space requirement increases when the work volume increases.
2. Mechanization of material handling is not possible or is very costly.
3. High work in progress inventory as jobs have to queue up for each operation.
4. Difficulty in scheduling work, as different jobs have different operation sequences.
5. High level of supervision is required. Production Planning and Control is more difficult.

(iii) Project Layout

The layout in which the production operation is performed in a fixed position is called the project layout or fixed position layout; for example, aeroplane and ship building industries use this type of layout. While making a rocket (the real ones, not fire crackers!) the workmen/scientists, machines and tools and raw materials are moved to the place of construction of the rocket. Building bridges, roads, the Metro rail etc., are all projects.

Advantages of project layout

1. It minimizes movement of machineries and equipment.
2. Continuity in production allows several activities to take place simultaneously.

Disadvantages of project layout

1. Skilled and versatile workers are required. The necessary combination of skills may be difficult to find. Suitable workers would have to be paid attractive salaries.
2. Once the project is over, the equipment/materials will have to be moved. Not only is this an expensive proposition but equipment utilization is also low since equipment is kept idle during the time that it is being shifted.

(iv) Group Layout

This layout is a combination of the layouts we have studied so far and is more commonly seen in the industry today. Group technology, or cellular manufacturing has the advantages of both process layout as well as line layout.

In group technology, parts are grouped into families. The layout consists of groups of different machines (called cells) that are necessary for the production of families of parts.

Advantages of group technology

1. The design of new products is good.
2. Production control is simpler than in Process layout or Project layout, since scheduling of machines is less complex and fewer tools and materials are required.
3. Material-handling costs are fewer than in Process layout.
4. There are savings in setup time which leads to increase in production.

6.4.1 Techniques and Types of Layout Planning

Plant location techniques refer to the location of facilities and the decisions that are to be made in that regard. In general, it can be said that an ideal location is one where there is minimum cost of product manufacturing, low risk, maximum market access, and social gain. Plant location is sometimes studied at three levels including

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regional, community and site factors. Further the factors affecting plant location can be divided into primary, secondary and miscellaneous factors. While the primary factors include elements like supply of raw material, nearness to the market, supply of labour and capital, transportation factors, etc.; the secondary factors include the natural environment. The community attitude, water disposal, suitability of land, etc., form the miscellaneous factors. In this section, we will instead focus on the plant layout involving the techniques and types of layout planning.

Line or product layout

This is easier to plan since the machines have to be arranged or laid out as per the sequence of operations involved in converting the raw material into finished goods. The problem in line layout is not of how to sequence or relatively position the work areas, but how to group the work elements in such a manner that there is very little idle time between the work centres.

Process layout

The problem in process layout is one of arranging the different work areas in such a way that the material movement costs are kept to a minimum. It is assumed that the other relevant costs of layout will also be reduced on account of this optimizing procedure.

The material handling costs between two work areas (departments) = {distance between the two work areas} $\times$ {Load handled between the two departments during a unit period of time}. (Here, load means the total number of units of different products any department processes).

The sum of these products, for all the combinations of departments, should be kept to the minimum for an optimal plant layout. This can be expressed as follows:

$$\text{Minimize } \sum D_{ij} \times L_{ij} \quad \dots 6.1$$

where, D_{ij} is the distance between departments i and j , and L_{ij} is the number of loads per unit time moved (handled) between departments i and j .

The starting point in such a mathematical optimization procedure for the Process layout is gathering data on the number of loads per unit time moved between different combinations of the work areas. This data is called 'load summary' and is presented in matrix fashion.

Closeness rating

Closeness ratings indicate the relative degree of desirability of having one department situated near another. These are very effective tools, especially in service facility layout planning; for example, in an MBA institution, it is advantageous to have the library and computer centre as close as possible to the lecture theatres. The boys' and girls' hostel should be as far apart as possible. The girls' hostel is usually located near the teachers' residential premises.

The closeness rating can be indicated as shown in Table 6.1.

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Table 6.1 Closeness Rating Significance

<i>Closeness rating</i>	<i>Importance</i>
Absolutely necessary	1
Highly important	2
Important	3
Slightly important	4
Unimportant	5
Undesirable	6

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Example 6.1

Indiana Hospital has made the following matrix to show the closeness ratings of the various departments for its proposed new building. The matrix shows that the closeness rating between departments D_1 and D_2 is 2, departments D_1 and D_3 is 4, D_6 and D_1 as 5, and so on.

Make a layout for the hospital building keeping in view the closeness ratings.

Solution:

Step 1: Make a list of department pairs with ratings 1. This is necessary.

$D_1 - D_4$
 $D_3 - D_4$
 $D_1 - D_9$
 $D_4 - D_8$
 $D_8 - D_9$

Make a list of department pairs with ratings 6. This is undesirable.

$D_2 - D_3$
 $D_5 - D_6$
 $D_2 - D_8$
 $D_4 - D_9$

Step 2: Now make a network of departments having the rating 1, with the department occurring most frequently (D_4) at the centre.

Similarly, make a network of departments having the rating 6, with the department occurring most frequently (D_2) at the centre.

Now, keeping in view the above combinations, place the departments in the nine cells as shown below. This placement satisfies all the conditions of not only departments with ratings 1 and 6 but also of those with other ratings. While making the placements, we have to consider only ratings 1 and 6; the other ratings are automatically satisfied.

Closeness ratings require a trial and error method for placement of departments. The Assignment method is more useful and commonly used in

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industry. Several computer software such as ALDEP (automated layout design programs) and CORELAP (computerized relationship layout planning) are based on the closeness ratings method. Another software, CRAFT (computerized relative allocation of facilities), is based on the load distance analysis method which is explained below.

Load Distance Analysis

In this method, two or more layouts can be compared to find out which one minimizes the total load-distance value of the product manufactured. Let us understand this technique by means of the following example.

Example 6.2

The figures shown below display two layout options of a facility: Layout A and Layout B. The distance between any two adjacent departments is 10 m. No diagonal movement is possible, e.g., if a load has to be moved from Department 7 to Department 5 in Layout A, it can be done either through Departments 8, 9, and 6 or through Departments 3, 1 and 2 by travelling a distance of 40 m. The table below shows the department processing sequence of various products and their quantity produced per month. Calculate which layout is better in terms of lower total load-distance value.

<i>PRODUCT</i>	<i>PROCESSING</i>	<i>QTY/MONTH SEQUENCE</i>
V	5 – 7 – 2 – 9	3000
W	4 – 3 – 8 – 1 – 5	4000
X	3 – 9 – 4 – 1	2000

Solution: Find the total distance travelled by a product while getting processed, according to the given sequence.

<i>PRODUCT</i>	<i>PROCESSING</i>	<i>DISTANCE LAYOUT A SEQUENCE</i>	<i>LAYOUT B</i>
V	5 – 7 – 2 – 9	40 + 30 + 30 = 100	30 + 10 + 10 = 50
W	4 – 3 – 8 – 1 – 5	10 + 20 + 30 + 20 = 80	10 + 30 + 10 + 30 = 80
X	3 – 9 – 4 – 1	30 + 20 + 20 = 70	20 + 30 + 10 = 60

Now multiply the load, i.e. quantity per month with the distance calculated.

<i>PRODUCT</i>	<i>QTY</i>	<i>QTY X DISTANCE LAYOUT A</i>	<i>LAYOUT B</i>
V	3,000	3,00,000	1,50,000
W	4,000	3,20,000	3,20,000
X	2,000	1,40,000	1,20,000
		7,60,000	5,90,000

The total load distance of Layout B is lesser than Layout A.

Hence, Layout B is a better option.

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Feasibility*

6.4.2 Size of the Business Firm

By size of the firm, one means the scale or volume of operation turned out by a single firm. The study of the size of a business is important because it significantly affects the efficiency and profitability of the firm. One of the most important entrepreneurial decisions in organizing a business is realizing its 'size' as it affects in company and profitability of business enterprises.

To measure the size of a business unit, the standards of measurement can be grouped into the following two categories.

- **Measures about Input:** This includes capital employed, net worth, total assets, labour employed, and raw material and power consumed.
- **Measure about Output:** This includes a volume of output, the value of output, and value-added.

The size of the business is a very important criterion when it comes to checking the locational feasibility.

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Check Your Progress

3. What are the properties of a good enterprise location?
4. What are the primary, secondary and miscellaneous factors affecting plant location?
5. What is Load Distance Analysis?
6. What is product layout?
7. State two advantages of process layout.
8. List two advantages of project layout.

6.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The environmental aspects of technology transfer that should be considered are the temperature level, moisture level, the quality of atmosphere, quality of material, method of work and skill of labour, and power supply quality.
2. Some technologies have the problem of waste disposal and may be proved costly: for example, nuclear power plants suffer with waste disposal problems. Several countries that have been using nuclear power plants have not found effective ways of waste disposal; some others have not been conscious about this issue yet and create unimaginable problems for future generations.

*Self-Instructional
Material*

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3. The properties of a good enterprise location are given below:
 - Nearness to market and nearness to raw materials
 - Early availability of transport facility at cheaper rates
 - Availability of skilled workers at cheaper rates
 - Incentives/concessions for industrially backward areas
 - Suitable land and building facilities
4. The factors affecting plant location can be divided into primary, secondary and miscellaneous factors. While the primary factors include elements like supply of raw material, nearness to the market, supply of labour and capital, transportation factors, etc.; the secondary factors include the natural environment. The community attitude, water disposal, suitability of land, etc., form the miscellaneous factors.
5. In Load Distance Analysis, two or more layouts can be compared to find out which one minimizes the total load-distance value of the product manufactured.
6. The placement of the equipment/machinery and materials in the order in which they are to be used for producing the product is called the product layout or line layout.
7. The advantages of process layout are as follows:
 - Flexibility in adapting to changing volumes, changing varieties.
 - Helps workmen learn more skills as job rotation enriches their skills.
8. The advantages of project layout are as follows:
 - It minimizes movement of machineries and equipment.
 - Continuity in production allows several activities to take place simultaneously.

6.6 SUMMARY

- The following inquiries must be made with respect to technology analysis:
 - o Availability of commercially exploitable technology and its alternatives
 - o Transferability of those technologies
 - o Other inquiries about the technologies
 - o Risk implications
 - o Resource availability
- A task force will search for technology for the operations required for running the project. If technology is available, commercial exploitability must be verified. If commercially available technology is available, then alternative technology and their sources are identified.

- The technology transfer issue has to be addressed in a dual fashion—(a) Whether the transfer of technology is possible from the political angle and (b) whether transfer of technology is possible from the operations (environment) angle.
- If the technology is transferable from the political viewpoint, one needs to check whether the technology would work in the environment where it will be transferred. Technology is usually very sensitive to the environment or climate in which it is used.
- Some of the other inquiries relating to technologies are concerned with the normal capacity utilization, production process, product mix, waste disposal problems, etc.
- The study of industrial locations forms an important part of an entrepreneurs jobs. Location an industry can impact the profit, productivity and growth of the organization.
- The selection of an ideal enterprise location enables the enterprise to operate economically, smoothly, and efficiently. Several times, the location of an enterprise can influence the success or failure of that plant. While selecting a site, the owner must consider technical, commercial, and financial aspects.
- Plant location techniques refer to the location of facilities and the decisions that are to be made in that regard. In general, it can be said that an ideal location is one where there is minimum cost of product manufacturing, low risk, maximum market access, and social gain.
- The factors affecting plant location can be divided into primary, secondary and miscellaneous factors. While the primary factors include elements like supply of raw material, nearness to the market, supply of labour and capital, transportation factors, etc.; the secondary factors include the natural environment. The community attitude, water disposal, suitability of land, etc., form the miscellaneous factors.
- Line or product layout is easier to plan since the machines have to be arranged or laid out as per the sequence of operations involved in converting the raw material into finished goods.
- The problem in process layout is one of arranging the different work areas in such a way that the material movement costs are kept to a minimum.
- Closeness ratings indicate the relative degree of desirability of having one department situated near another. These are very effective tools, especially in service facility layout planning.
- In Load Distance Analysis, two or more layouts can be compared to find out which one minimizes the total load-distance value of the product manufactured.

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- Once the facility location has been decided and land has been acquired, a sketch or plan is made to decide where each department/section, entrance and exit gates, restrooms, storage areas, etc., will be located.
- Plant layout is the method to plan and arrange materials and facilities so that a steady flow of production is ensured at minimum cost. A good plant layout always results in comfort and satisfaction of workmen and this automatically increases the production. A bad plant layout leads to accidents and unnecessary problems.
- There are four basic types of layout: product layout, process layout, project layout, and group layout.
- The placement of the equipment/machinery and materials in the order in which they are to be used for producing the product is called the product layout or line layout.
- The layout in which all the equipment/machineries performing similar tasks are grouped together is called the process layout or functional layout.
- The layout in which the production operation is performed in a fixed position is called the project layout or fixed position layout.
- Group technology, or cellular manufacturing has the advantages of both process layout as well as line layout. In group technology, parts are grouped into families. The layout consists of groups of different machines (called cells) that are necessary for the production of families of parts.
- By size of the firm, one means the scale or volume of operation turned out by a single firm. The study of the size of a business is important because it significantly affects the efficiency and profitability of the firm. One of the most important entrepreneurial decisions in organizing a business is realizing its 'size' as it affects in company and profitability of business enterprises.

6.7 KEY WORDS

- **Layout:** It refers to the physical location of the various departments/units of a facility within the premises of the facility.
- **Product layout:** The placement of the equipment/machinery and materials in the order in which they are to be used for producing the product is called the product layout or line layout.
- **Process layout:** The layout in which all the equipment/machineries performing similar tasks are grouped together is called the process layout or functional layout.
- **Project layout:** The layout in which the production operation is performed in a fixed position is called the project layout or fixed position layout.

6.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What are the two important aspects of technology transfer issue?
2. Why is it important to estimate the rate of change in technology?
3. Write a short note on process layout.
4. What are the disadvantages of project layout?

Long-Answer Questions

1. Discuss in detail the important aspects of technology analysis.
2. Explain the objectives a good plant layout attempts to achieve.
3. Examine the advantages of a good plant layout.
4. Analyse the advantages and disadvantages of the four types of layout.

6.9 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
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UNIT 7 MANAGERIAL AND LEGAL FEASIBILITY

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Structure

- 7.0 Introduction
- 7.1 Objectives
- 7.2 Managerial Feasibility
- 7.3 Legal Feasibility
 - 7.3.1 Characteristics and Types of Companies
 - 7.3.2 Laws Applicable for Entrepreneurship
- 7.4 Answers to Check Your Progress Questions
- 7.5 Summary
- 7.6 Key Words
- 7.7 Self Assessment Questions and Exercises
- 7.8 Further Readings

7.0 INTRODUCTION

This unit will delve into the concept of managerial and legal feasibility. Managerial feasibility is concerned with the competence and ethical values of promoters which can be judged by referring to certain parameters. These parameters have been discussed in this unit. The legal feasibility should also be considered as there are various laws put in place to protect intellectual property. The concept of copyright, trademark, patent and trade secret will be examined. The characteristics and types of business organisations will also be explained in this unit.

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the concept of managerial feasibility
- Explain the classifications of business organisations
- Explain legal feasibility and the importance of laws put in place to protect intellectual property

7.2 MANAGERIAL FEASIBILITY

It is basically a study of the competences and ethical values of the promoters. Financial institutions are generally focused on the background of promoters in terms of their experience, education, and economic soundness to repay the loan amount. The appraisal of the management is indeed the touchstone of term credit analysis. It is so because the success or failure of any enterprise depends upon the

direction and efficiency of the management. In the absence of managerial competence, the project which is otherwise feasible may fail. On the other hand, a poor project may turn out to be a successful one with efficient managerial ability. Managerial competence can be judged with reference to the following:

1. Educational background of promoters
2. Previous experience in the field and managerial competence
3. Possession of entrepreneurial talents
4. Honesty, integrity and reputation of promoters
5. Possession of adequate know-how of the business

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7.3 LEGAL FEASIBILITY

Legal feasibility is a type of feasibility study which checks whether the business venture is not in conflict with laws of the region. For this the understanding and definition of companies and laws governing them is important. There are three basic legal forms of business formation 1) proprietorship, 2) partnership and 3) corporation, with variations particularly in partnerships and corporations. A new form that is gaining acceptance is the Limited Liability Company (LLC). The typical corporation form is known as C Corporation which is the most common form of corporation, regulated by statute and treated as a separate legal entity for liability and tax purpose.

The legal issues related to entrepreneurship are mainly related to intellectual property which includes patents, trademarks, copyrights and trade secrets which in general, represents important assets to the entrepreneur and should be understood even before engaging the services of an attorney. Most of the entrepreneurs, due to their lack of understanding of intellectual property, ignore important steps that they should have taken to protect these assets. At different stages of the start-up, the entrepreneur will need legal advice because all businesses are regulated by law, hence, the entrepreneur needs to be aware of any regulation that may affect his or her new venture. The requirement of legal expertise will vary based on the factors as whether the new venture is a franchise, an independent start-up or a buyout; whether the new venture produces a consumer versus an industrial product; whether it is nonprofit organization and whether it involves some aspect of computer software, whether it deals with conceptual product such as financial product or insurance, exporting, or importing.

There are many options that an entrepreneur can choose in setting up an organization, hence, it will be necessary to understand all the advantages and disadvantages of each, regarding the issues such as costs of setting up, taxes, liability, continuity, transferability of interest and attractiveness for raising capital. Legal advice for these agreements is necessary to ensure that the most appropriate decisions have been made.

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Legal Documentation

The legal documents essential for an entrepreneur are:

- The formation of business entity such as partnership deed, Memorandum of Association
- Setting up books and records for tax purposes, sales registers, employee remuneration registers etc.
- Negotiating lease and financing, royalty agreements
- Writing contracts with partners and employees, period of contract and amount of contracts procedure of bill settlement, employees' remuneration and period of contract
- Advising about insurance needs and requirements
- Consultancy services contracts
- Sales promotion agreements with advertising agencies
- Patents, trademarks and copyright – agreement with authorized person or institute on patents, trademark and copyright.

There is an old saying that 'a person who represents himself in a legal matter has a fool for a client'. However, an entrepreneur who insists on self-representation, he or she should be conversant with the content and the process of the law.

In this section, you will first learn about the characteristics and types of company, followed by the legal issues related to entrepreneurship.

7.3.1 Characteristics and Types of Companies

The broad classification of the forms of business organizations includes: (i) sole-proprietorship, (ii) partnership, and (iii) corporate form of business organizations. Partnerships can be regular and limited; and companies can be private or public. Companies can also be either for-profit or non-profit organizations.

Let us have a look at each of the forms of business organization in brief.

Sole Proprietorship Form of Business Organization

Formation of sole-proprietorship and running it has no legal costs. The owner has full control over business and its management. Since the owner and business are not separate, business income is considered as personal income and taxed as individual income, avoiding double taxation. The owner has unlimited liability in business; the owner is responsible for business liabilities creating risk on personal assets, if the business fails. Life of a sole-proprietorship business is limited. As sole proprietorship business is a personal affair of the owner and there are no legal restrictions, it also has a limited access to funds.

Partnership Form of Business Organization

In terms of advantages and disadvantages, partnerships are no different from sole-proprietorships, except that in partnership more than one owner pools resources and shares liability. Formation is easy too, except that a written agreement, though not required, is advisable; and it is desirable (though not compulsory) to register the partnership. Life of partnership becomes further limited because the partnership breaks with retirement or death of any one partner.

Limited partnership

Through an agreement, one or few partners can be offered limited liability to the extent of contribution in capital (or to any amount agreed upon). The condition is, at least one partner has to have unlimited liability. Usually, limited partners are also 'sleeping' or 'dormant' partners, which means they do not take active part in managing the business of partnership.

Corporate Form of Business Organization

Instead of a partnership, one can form a company by registering the firm under the Companies Act, 1956. A company is a legal entity separate from its owners and therefore, the owners are not liable for the company's liabilities. Owners enjoy limited liability; limited to the extent of share capital provided by the member and not more. There is a legal process to follow and documents to file along with the registration fees for the registration of a firm as a company. Also, once a company is registered, it has to comply with several legal requirements from time to time. The owners of the company are called 'members' or 'shareholders'.

Private company

A company can be registered as a private limited company, subject to the regulatory limit on number of members (minimum two and maximum fifty) and a minimum paid-up capital of ₹1 lakh. Legalities in the formation and during operations are less if the company is registered as a private limited company.

Public company

A public limited company is one which is not a private company but has a minimum paid-up capital of ₹5 lakh. A public company can be formed with minimum seven members and has no upper limit on the number of membership. A public company can give invitation to the public for subscription in the share capital or bonds of the company. Public companies are subject to more stringent legal requirements for the formation of the public company and the reporting requirements during existence.

The basic features of the three main forms of business organizations are compared in Table 7.1.

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Table 7.1 Comparison of Basic Features of Three Major Forms of Business Organizations

	Sole-proprietorship	Partnership	Corporations
Legalities at formation stage	Very little	Agreement is needed	Elaborate
Legalities later	None	None	Regular filing of reports
Personal liabilities of owners	Yes	Yes, except that of limited partner	Only to the extent of par value of capital
Access to capital	Personal and private sources only • Limited capital, small size • High cost of capital	Personal and private sources only • Limited capital, small size • High cost of capital	Can invite public to participate in capital • More capital • Size can be large
Control over business	Absolute	Subject to share in partnership and agreement	Subject to, • shareholding of Management • Concentration of shareholding
Tax implications	• Business income is taxed as personal income • Rate could be high	• Business income is taxed as personal income • Rate could be high	• Business income is taxed • Dividend is also taxed
Life	Limited Owner's demise would invite estate duty	Limited: One partner's separation or demise would invite re-agreement and estate duty	Unlimited Easy succession without any estate duty

Franchising

‘Franchising is a continuing relationship in which a franchisor provides a licensed privilege to the franchisee to do business and offers assistance in organizing, training, merchandising, marketing and managing in return for a monetary consideration. Franchising is a form of business by which the owner (franchisor) of a product, service or method obtains distribution through affiliated dealers (franchisees).’

Buying a franchise may have several advantages for a franchisee. Usually a franchisor would grant a franchise only if market potential is observed, technical support could be provided and only after verifying the financial viability. Franchise is just an arrangement between a franchisor and a franchisee, and has no bearing on a form of business organization under which a franchisee would run the business.

7.3.2 Laws Applicable for Entrepreneurship

In this section, you will learn about important laws whose knowledge is necessary to complete legal feasibility.

Protecting Intellectual Property

In today’s economic and business world it is important that you establish your right over your intellectual contribution and also protect the same. Many Indian entrepreneurs are still naïve in this matter and subsequently pay for its price.

Establish Ownership over Innovations/Contributions

If your business idea is new, if your product or its process is different, if you have produced something worthwhile based on your intellectual capacity then it is very important to first establish your ownership right on them before a business is built around it. Most important laws that one must know are: (i) Patents Act, 1970, (ii) Trademarks Act, 1999, (iii) Copyright Act, 1957 and (iv) the Trade Secret.

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(i) Patents Act, 1970

It is important to get patent for the innovation you have made, whether you have interest in commercializing it or not. A patent can be granted for an invention which may be related to any process or product. The Patents Act, 1970, defines the term 'invention' as amended from time to time.

'An invention means a new product or process involving an inventive step and capable of industrial application.' (Section 2(1)(j))

'New invention' is defined as any invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e. the subject matter has not fallen in public domain or that it does not form part of the state of the art; where, capable of industrial application, in relation to an invention, means that the invention is capable of being made or used in an industry. (Section 2 (1)(ac))

Patent rights are always country specific, though of late through the WTO there is an attempt to narrow down the differences. Patents (Amendment) Act, 2005, is the third of the three amendments to the Patents Act of 1970, to bring India's patent regime into compliance with the WTO TRIPs Agreement.

In India, a governing law is the Indian Patents Act, 1970. This Act distinguishes patentable and non-patentable inventions and gives a negative list of non-patentable inventions. Once the patent is granted to an applicant, the Patents Act 1970, the inventor acquires an exclusive right for his invention for a given time frame. Generally, patent rights are good for twenty years, but the patent rights are limited to only seven years in case the invention is related to manufacturing of food or drugs or medicines. Getting patent is not easy. Several attorneys are available for getting the patent registration.

(ii) Trademarks Act, 1999

Trademark performs several functions, some of which are as follows:

- Advertising the product/service and helping in recall value
- Identification of product/service and its origin
- Guaranteeing the constant quality
- Creating image and brand name

Trademarks are usually a combination of a character, word, name, design, colour and any combinations of these. It should be designed such that it creates distinctive image and help in recalling the image without any confusion.

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‘Trade name identifies the firm and that is a symbol of reputation and goodwill of the firm. On the other hand, trademark differentiates the goods and services of a firm.’

According to the Trademarks Act:

“Trademark means a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours; and

- (a) in relation to Chapter XII (other than section 107), a registered trademark or a mark used in relation to goods or services for the purpose of indicating or so as to indicate a connection in the course of trade between the goods or services, as the case may be, and some person having the right as proprietor to use the mark; and
- (b) in relation to other provisions of this Act, a mark used or proposed to be used in relation to goods or services for the purpose of indicating or so to indicate a connection in the course of trade between the goods or services, as the case may be, and some person having the right, either as proprietor or by way of permitted user, to use the mark whether with or without any indication of the identity of that person, and includes a certification trade mark or collective mark.

Though one can use any name and symbol as a trade name or trademark, the exclusions are defined under the Emblems and Names (Prevention of Improper Use) Act, 1950, which prohibits the use of certain names and emblems. For example, use of the word India or any state name, use of national emblem, among others, are prohibited as a trade name or trademark.

The trademark is issued for perpetuity, provided that the trademark is used and renewed periodically and that the registered proprietor takes quick action against infringement, if any. The trademark has to be renewed every ten years.

(iii) Copyright Act, 1957

- (1) For the purposes of this Act, ‘copyright’ means the exclusive right, by the virtue of and subject to the provisions of, this Act,
 - (a) in the case of a literary, dramatic or musical work, to do and authorize the doing of any of the following acts, namely:
 - (i) to reproduce the work in any material form;
 - (ii) to publish the work;
 - (iii) to perform the work in public;
 - (iv) to produce, reproduce, perform or publish any translation of the work;

- (v) to communicate the work by radio-diffusion or to communicate to the public by a loud-speaker or any other similar instrument the radio-diffusion of the work;
 - (vi) to make any adaptation of the work;
 - (vii) to do in relation to a translation or an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (vi);
- (b) in the case of an artistic work, to do or authorize the doing of any of the following acts, namely:
- (i) to reproduce the work in any material form;
 - (ii) to publish the work;
 - (iii) to include the work in any cinematograph film;
 - (iv) to make any adaptation of the work;
 - (v) to do in relation to an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (iii).
- (c) in the case of a cinematograph film, to do or authorize the doing of any of the following acts, namely:
- (i) to make a copy of the film;
 - (ii) to cause the film, in so far as it consists of visual images, to be seen in public and, in so far as it consists of sounds, to be heard in public;
 - (iii) to make any record embodying the recording in any part of the sound track associated with the film by utilising such sound track;
 - (iv) to communicate the film by radio-diffusion;
- (d) in the case of a record, to do or authorize the doing of any of the following acts by utilising the record, namely:
- (i) to make any other record embodying the same recording;
 - (ii) to cause the recording embodied in the record to be heard in public;
 - (iii) to communicate the recording embodied in the record by radio-diffusion.
- (2) Any reference in sub-section (1) to the doing of any act in relation to a work or a translation or an adaptation thereof shall include a reference to the doing of that act in relation to a substantial part thereof.

Duration of Copyright

The copyright period expires after sixty years from the beginning of the next calendar year following the year in which the author dies. Thus, a minimum copyright duration is equal to the life of the copyright owner plus sixty years rounded to the next full year.

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Assignment of copyright

Rights can be assigned for any part of copyright material either for the whole term or part of it. Such assignment can be made a part of contract or may be drafted separately. A good copyright assignment contract will be for a specific work, specific right, specific duration and specific territorial extent. The royalty amount also must be specified in the assignment contract. If the period of assignment of copyright is not stated in the contract then it is assumed to be of five year duration from the date of assignment.

Assignment of License

A license grants authority to do specific things. Without such authorization if something is done which is protected by the Copyright Act, then it amounts to an infringement.

Infringement

Infringement of the Copyright Act is a criminal activity and is punishable under Section 63 of the Copyright Act 1957.

(iv) Trade secret

In this competitive age supported by information technology, it is necessary that a business protects its new formula, product, technology, customer lists, business processes, or future business plans. A trade secret is data or information related to the business, which is not known to the public, and in which the firm has a business interest to protect its secrecy and confidentiality. Leakage of such data and information may result a firm into losing a competitive edge over its competitors.

Though, protection of trade secret is very essential, unfortunately, there is no special act for the protection of trade secret matters in India. Therefore, it is very important to carefully design all contracts (with employees, suppliers, contractors, among others) for the maintenance of trade secrets.

The trade secrets are protected under the common law, though the Indian Contract Act (section 27) provides some limited recourse, because this section bars any person from disclosing any information acquired as a result of a contract.

Protecting trade secret

In the absence of a specific law, there are some methods through which a business can protect its trade secret. Some of the suggested methods are:

- Employment agreement
- Trade secret policy
- Non-disclosure agreement
- Adequate documentation
- Security system

Inclusion of confidentiality clause, non-competitive clause, among others, in the employment contract, along with consequences of non-adherence to these

clauses, is something that is easily done. These clauses debar the employee from unfairly using sensitive information and knowledge acquired as an employee in a manner that is detrimental to the interest of the employer. For example, an employee who handles secret formula cannot either start his own business or join a competitor for a certain period after separation from the current employment.

A firm must develop a trade secret policy and make everyone aware of it. This includes identification of trade secrets and prioritizing them based on their sensitivity and significance. The consequences of breach of trust also must be made clear in the policy. Employee must be made aware of the policy and asked to sign the copy.

Non-disclosure agreements are usually with third parties with whom the firm does business. Vendors, suppliers, customers and contractors may be asked to sign the non-disclosure agreement so that they do not misuse the information, knowledge or document acquired by them during the course of discussion/business with the firm.

Need for adequate documentation is always there despite having policies, contracts and agreements. Documentation helps in enforcing the consequences of violating agreement, and it also works as a deterrent from misuse. Documentations are also useful when trade secret audit is conducted.

Building a security system is equally necessary for avoiding conflicts that may arise from the violation of trade secret contracts. The security system means, involving only a few select people in those activities where vital trade secrets lie, allowing restricted entry, checking before entry, ensuring authentication before work begins, firewalls, virus scans, security cameras and many preventive measures.

Legal Issues

Legal issues are encountered at the start up stage as well as during the operations, at the time of strategic growth, at the time when venture capitalist exit and even when a business is wound up.

Start-up related laws

Whatever the form of business organization that an entrepreneur selects, he would encounter some legalities for which a familiarity with the Indian Partnership Act, 1932, or the Limited Liability Partnership Act, 2008, and the Indian Companies Act, 1956, is essential.

Business and mercantile laws

During the operations one must have working knowledge of mercantile laws as well as labour laws. Mercantile laws include several laws that would govern the day-to-day activities of business. Most important mercantile laws are:

- Sales of Goods Act, 1930
- Negotiable Instrument Act, 1881
- Contract Act, 1872

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- Consumer Protection Act, 1986,
- Shops and Establishment Act, 1948

Labour laws

All labour laws are not applicable to all businesses. The application criterion is usually prescribed in labour law. Some of the important labour laws applicable to qualifying businesses are as follows:

- Industrial Dispute Act, 1947
- Trade Union Act, 1926
- Minimum Wages Act, 1948
- Payment of Wages Act, 1936
- The Workmen's Compensation Act, 1923
- The Factories Act, 1948
- The Contract Labour Act, 1970

Taxations

Implications of business operations on tax laws are also important (Income Tax Act, 1962). Some taxes are levied by the Central government and some by the State government. Central government levies the tax on all types of incomes and also charges custom duties on import and export, charges central excise on manufacturing activity and charges service tax on almost all kinds of services. The State government also collects agricultural income tax, Value Added Tax (VAT)/ Sales Tax, Stamp Duty, State Excise, Land Revenue, Luxury Tax and Tax on Professions. The local bodies like municipalities and Municipal Corporation can also collect various taxes like tax on properties, octroi or entry tax and tax for utilities like water supply, drainage, among others.

Check Your Progress

1. What are the criteria on the basis of which managerial competence can be judged?
2. What should be the minimum paid up capital of a public limited company?
3. What are functions performed by trademarks?
4. What is the difference between trade name and trademark?
5. What is the duration of a copyright?
6. What are some of the methods used to protect trade secrets?
7. List some of the important mercantile laws.

7.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

*Managerial and Legal
Feasibility*

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1. Managerial competence can be judged with reference to the following:
 - Educational background of promoters
 - Previous experience in the field and managerial competence
 - Possession of entrepreneurial talents
 - Honesty, integrity and reputation of promoters
 - Possession of adequate know-how of the business
2. A public limited company should have a minimum paid-up capital of 5 lakh.
3. Trademark performs several functions, some of which are as follows:
 - Advertising the product/service and helping in recall value
 - Identification of product/service and its origin
 - Guaranteeing the constant quality
 - Creating image and brand name
4. Trade name identifies the firm and that is a symbol of reputation and goodwill of the firm. On the other hand, trademark differentiates the goods and services of a firm.
5. The copyright period expires after sixty years from the beginning of the next calendar year following the year in which the author dies. Thus, a minimum copyright duration is equal to the life of the copyright owner plus sixty years rounded to the next full year.
6. Some of the methods used for protecting trade secrets are:
 - Employment agreement
 - Trade secret policy
 - Non-disclosure agreement
 - Adequate documentation
 - Security system
7. The important mercantile laws are given below:
 - Sales of Goods Act, 1930
 - Negotiable Instrument Act, 1881
 - Contract Act, 1872
 - Consumer Protection Act, 1986
 - Shops and Establishment Act, 1948

*Self-Instructional
Material*

7.5 SUMMARY

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- Managerial feasibility is basically a study of the competences and ethical values of the promoters. Managerial competence can be judged with reference to the following:
 - (a) Educational background of promoters
 - (b) Previous experience in the field and managerial competence
 - (c) Possession of entrepreneurial talents
 - (d) Honesty, integrity and reputation of promoters
 - (e) Possession of adequate know-how of the business
- The broad classification of the forms of business organizations includes: (i) sole-proprietorship, (ii) partnership, and (iii) corporate form of business organizations. Partnerships can be regular and limited; and companies can be private or public. Companies can also be either for-profit or non-profit organizations.
- In sole proprietorship form of business organization, the owner has full control over business and its management. Since the owner and business are not separate, business income is considered as personal income and taxed as individual income, avoiding double taxation.
- Partnership Form of Business Organization no different from sole proprietorships, except that in partnership more than one owner pools resources and shares liability.
- Through an agreement, one or few partners can be offered limited liability to the extent of contribution in capital (or to any amount agreed upon). The condition is, at least one partner has to have unlimited liability. Usually, limited partners are also 'sleeping' or 'dormant' partners, which means they do not take active part in managing the business of partnership.
- One can form a company by registering the firm under the Companies Act, 1956. A company is a legal entity separate from its owners and therefore, the owners are not liable for the company's liabilities.
- A company can be registered as a private limited company, subject to the regulatory limit on number of members (minimum two and maximum fifty) and a minimum paid-up capital of 1 lakh.
- A public limited company is one which is not a private company but has a minimum paid-up capital of 5 lakh. A public company can be formed with minimum seven members and has no upper limit on the number of membership.
- Franchising is a continuing relationship in which a franchisor provides a licensed privilege to the franchisee to do business and offers assistance in

organizing, training, merchandising, marketing and managing in return for a monetary consideration. Franchising is a form of business by which the owner (franchisor) of a product, service or method obtains distribution through affiliated dealers (franchisees).

- In today's economic and business world it is important that you establish your right over your intellectual contribution and also protect the same. Most important laws that one must know are: (i) Patents Act, 1970, (ii) Trademarks Act, 1999, (iii) Copyright Act, 1957 and (iv) the Trade Secret.
- Indian Patents Act, 1970 distinguishes patentable and non-patentable inventions and gives a negative list of non-patentable inventions. Once the patent is granted to an applicant, the Patents Act 1970, the inventor acquires an exclusive right for his invention for a given time frame.
- Trademarks are usually a combination of a character, word, name, design, colour and any combinations of these. It should be designed such that it creates distinctive image and help in recalling the image without any confusion.
- Infringement of the Copyright Act is a criminal activity and is punishable under Section 63 of the Copyright Act 1957.
- A trade secret is data or information related to the business, which is not known to the public, and in which the firm has a business interest to protect its secrecy and confidentiality. Leakage of such data and information may result a firm into losing a competitive edge over its competitors.
- Legal issues are encountered at the start up stage as well as during the operations, at the time of strategic growth, at the time when venture capitalist exit and even when a business is wound up.

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7.6 KEY WORDS

- **Dormant partners:** It is a partner who takes no share in the active business of a company or partnership, but is entitled to a share of the profits, and subject to a share in losses
- **Franchising:** It is a form of business by which the owner (franchisor) of a product, service or method obtains distribution through affiliated dealers (franchisees).
- **Copyright:** It is a type of intellectual property that gives its owner the exclusive right to make copies of a creative work, usually for a limited time.
- **Trade secret:** It refers to data or information related to the business, which is not known to the public, and in which the firm has a business interest to protect its secrecy and confidentiality

7.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What do you mean by franchising?
2. Write a short note on Trademarks Act, 1999.
3. What is a copyright?
4. What are some of the important labour laws?

Long-Answer Questions

1. Explain the broad classifications of business organizations.
2. Examine the important laws put in place to preserve intellectual property.
3. Discuss in detail the methods by which a company can protect its trade secrets.

7.8 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
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UNIT 8 PROJECT APPRAISAL

Structure

- 8.0 Introduction
- 8.1 Objectives
- 8.2 Classification of the Project
- 8.3 Process of Risk Management
- 8.4 Types of Risk
 - 8.4.1 Marketing Risk
 - 8.4.2 Liquidity Risk
 - 8.4.3 Credit Risk
 - 8.4.4 Operational Risk
 - 8.4.5 Need and Benefits of Risk Management
- 8.5 Answers to Check Your Progress Questions
- 8.6 Summary
- 8.7 Key Words
- 8.8 Self Assessment Questions and Exercises
- 8.9 Further Readings

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8.0 INTRODUCTION

Project classification is needed in order to build an effective system for decision-making. By categorizing the project, a business can focus on important thrust areas and avoid potential losses. The process of risk management involves steps that identifies potential losses, evaluates them and then selects appropriate technique to deal with loss exposure. It should be noted that firms are exposed to different types of risk. These risks may be categorized into business risk, non-business risks and financial risks. This unit will discuss in detail marketing risk and its various types. The benefits of risk management will also be explained.

8.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe the need for project classification
- Discuss the process of risk management
- Explain the various types of risk
- Discuss marketing risk

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8.2 CLASSIFICATION OF THE PROJECT

After a project proposal is conceptually cleared, it enters the analysis stage. Several types of analysis are done with two-fold objectives-risk assessment via improving the information base so that one has to rely less on intuition; and generate information so that one can do cost-benefit analyses.

The benefits from a project must outweigh its costs. Costs and benefits are studied at various stages of the capital budgeting process. When the initial feasibility report is prepared, the costs and benefits are at best guesstimates based upon experience or thumb rules. At the time of preparation of a detailed project report, all costs and benefits are projected upon the basis of studied assumptions.

A suitable classification of projects gives a solid logic for building a system for effective decision-making. Table 8.1 gives the bases of project classification and their objectives.

Table 8.1 Classification and Objective of each Criterion of Classification

Classification Criteria	Classification	Objective
1. Occurrence	Capital schemes and revenue schemes or Routine and non-routine	Delegation
2. Project size	Large and small	Delegation
3. Types of benefits	Tangible and non-tangible or Strategic and tactical	Delegation Capital rationing Long-term growth Cost-benefit projection
4. Degree of dependence	Mutually exclusive Complimentary Substitute	Cash flow projection Evaluation need
5. Nature of project	Replacement Addition/acquisition of production facilities Research and development Maintenance facilities and services Housing, welfare and amenities	Delegation Risk study
6. Type of cash flow	Conventional Non-conventional Annuity type Mix-stream	Designing financial instrument

One large manufacturing firm in India followed the classification as given in Table 8.2.

Table 8.2 Project Classification in a Large Indian Firm

Classification of schemes	Categorization of schemes
CAPITAL SCHEMES	
1. Major Scheme : $\geq$ ₹ 50 lakh	1. Replacement
2. Minor Scheme : $<$ ₹ 50 lakh	2. Addition/augmentation of production
3. Equipment and Furniture Scheme : $\leq$ ₹ 0.3 lakh	3. Maintenance facility and services
REVENUE SCHEME	4. Housing, welfare and amenities, etc.
Repair and Maintenance : No ceiling	

Note: The cut-off figures must have been changed now.

The rupee value cut-off is frequently reviewed and revised upward. Categorization of schemes also changes as per the changing focus of business. Strategic thrust areas are reflected in the categorization of the schemes.

Project Appraisal

8.3 PROCESS OF RISK MANAGEMENT

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Risk is generally perceived as an uncertainty relating to the occurrence of a loss such as risk of death in an accident, risk of loss due to fire and so on. Risk, however, has a different meaning. It represents a condition in which there is a possibility that the actual outcome deviates adversely from the expected outcome. In other words, risk is present when actual loss is likely to be more than the expected loss or when the actual returns from an investment are likely to be less than the expected returns. In businesses, decisions are taken based on possible future benefits. Proper analysis of the risk is therefore crucial to business decision making and project appraisal.

There are three steps in the process of risk management. They have been discussed as follows:

1. Identifying potential losses

The first step in the process of risk management is identification of potential losses for all types of risks. The following sources of information can be used for identifying potential losses:

- Risk managers can be asked to fill questionnaires aimed at identifying various loss exposures.
- Risk exposure checklists can be prepared by different segments of the firm.
- Insurance policy checklists are available which offer insurance covers for different types of risks. These checklists can be referred to in order to identify the risks facing the firm.
- Advice of experts in the field of risk management can be obtained.
- Physical inspection of a firm's facilities can be carried out to identify major loss exposures.
- Financial statements provide information about the assets and sources of income that require protection.
- Historical data on losses can be used to identify loss exposures.
- Analysis of contracts can help to identify risks that have been transferred to other parties and the risks against which protection is needed.

2. Evaluating potential losses

Credit risk is evaluated on the basis of the amount of credit exposure, the likelihood of default or deterioration of the credit standing and the recoveries under default.

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Market risk is captured through the Value at Risk (VaR) technique, volatility measures and different sensitivity measures such as beta, duration, delta and so on. Evaluation of operational risk involves estimation of potential frequency and severity of loss. Frequency of loss is the probable number of losses that are likely to occur in a given time period. The severity of the loss is the probable amount of loss.

3. Selecting the appropriate technique for treating loss exposure

Techniques available for handling loss exposure include avoidance, loss control, retention, non-insurance transfers and insurance. The applicability and desirability of these techniques is discussed as follows:

- **Risk avoidance:** Avoidance implies avoiding the risk altogether. For instance, a firm can avoid the risk of loss arising out of customer defaults by deciding not to extend any credit. It is not practically possible to avoid all risks. One has to decide what risks are reasonable to assume.
- **Loss control:** Loss control involves activities designed to reduce the frequency and severity of losses. Two major components of loss control are loss prevention and loss reduction. Loss prevention aims at reducing the frequency of losses. For instance, loss by theft may be prevented by having adequate security arrangements and bad debt losses may be prevented using strict credit appraisal.

The purpose of loss reduction is to reduce the severity of loss after it occurs. For instance, loss from bad debts can be reduced by not allowing further credit to delinquent accounts and losses from decline in prices of securities can be reduced by putting stop loss limits.

- **Risk retention:** In case of retention, the firm retains all or part of a given risk. Retention is advisable when,
 - (i) No other method of handling the loss is available (for instance, commercial insurance is not available),
 - (ii) The worst possible loss is not serious
 - (iii) Losses are highly predictable

For instance, a firm may decide not to take an insurance policy for losses arising out of petty thefts by employees and shop-lifting by customers.

- **Non-insurance transfers:** In non-insurance transfers, the risks are transferred to a party other than an insurance company, using contractual clauses (for instance, entering into a fixed price contract with a building contractor to transfer the cost escalation risk), factoring (transferring credit risk to a third party called factor) and hedging transactions (for instance, using derivative securities to offset risks arising out of fluctuations in the prices of underlying securities).

It is possible to transfer uninsurable exposures using non-insurance transfers. Potential losses may be shifted to someone in a better position to exercise loss control and it may cost less than insurance. However, there is a danger that the transfer of potential loss may fail due to ambiguity in the language of contractual clauses. In some cases, the firm may still be liable if the transferee of the risk fails to pay for the loss.

- **Insurance:** Insurance is the most practical method of handling risks in most of the cases. When a firm uses insurance, it has to decide on the insurance coverage and has to select the insurer. Insurance has many advantages. It indemnifies the insured after a loss occurs. It also reduces the uncertainty faced by the insured. The insured also gets access to valuable risk management services provided by insurance companies and the insurance premiums are eligible as deductible expenses from income for income tax purposes. On the other hand, insurance is costly. A firm has to spend considerable time and effort in negotiating with insurance companies. Insurance also leads to a lax attitude by the firm towards loss control. Insurance is advisable for risks such as fires and explosions where the frequency of risks is low but the severity of loss is high.

Check Your Progress

1. State the three steps involved in the process of risk management.
2. What are the techniques used to handle loss exposure?
3. What are the two major components of loss control?

8.4 TYPES OF RISK

Firms are exposed to various types of risks. These can be broadly classified into the following: Business risk, non-business risks and financial risks. These have been explained in the following lines.

- **Business risks:** These are the risks that a firm willingly assumes as a part of its business activities. They relate to the product market in which the firm operates. They arise due to technological, competitive and consumer-related factors. Business risks also include risks arising out of operating leverage (the degree of fixed costs versus variable costs) and macroeconomic factors such as economic cycles, changes in incomes and so on.
- **Non-business risks:** These are the risks over which firms have no control. They include strategic risks and financial risks. Strategic risks result from fundamental shifts in the economy or political environment. Expropriation and nationalization are examples of such risks. Financial risks relate to possible losses in financial markets, such as losses due to changes in interest rates or defaults on financial obligations by counterparties.

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- **Financial risks:** These risks can be divided into market risk, credit risk and operational risk.

8.4.1 Marketing Risk

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Marketing risk arises due to movement in financial variables such as security prices, interest rates, foreign exchange rates and commodity prices. The risk is that of fluctuations in portfolio value due to changes in these financial variables. Marketing risks can be further classified into: Price risk, currency risk, interest rate risk and commodity risk.

1. Price risk

Price risk arises due to unfavourable movement in the prices of securities or other obligations. Price risk is also very important for an investment institution. It has a different impact on short (sale) and long (purchase) positions. the various types of price risks have been discussed as follows:

- (i) **Symmetrical and non-symmetrical risk:** When a firm holds a portfolio of equity shares, an increase or decrease in the price of an equity share by an equal amount will have an equal corresponding (positive or negative) change in the value of the portfolio. This is an example of a symmetrical price risk. However, if the firm holds a portfolio of options (say, put options), a fall in the price of the underlying security will result in a corresponding increase in the value of the portfolio. On the other hand, an equal increase in the price of the security beyond the strike price does not decrease the value of the portfolio by an equal amount due to inherent characteristics of option contracts. This is an example of an unsymmetrical price risk.

A symmetrical risk, therefore, implies that the movement of an asset price in either direction leads to a corresponding effect on the portfolio value. The effect is unequal in the case of an unsymmetrical risk.

- (ii) **Absolute and relative risk:** Absolute risk is calculated with reference to initial investment. Relative risk is calculated with reference to a benchmark such as a stock index. For instance, if an initial investment of Rs 100 declines to Rs 90 due to fall in prices, the absolute negative return is 10 per cent. If the index during the same period has declined by 5 per cent, the relative return is worse than the return on the index. In the case of an investment fund, the market risk is often measured in relation to a benchmark index or portfolio, and is therefore referred to as 'risk of tracking error'.
- (iii) **Directional and non-directional risk:** Exposure to the direction or movement of a financial variable involves directional risk. Linear measures such as beta (for equity shares), duration (for fixed income securities) and delta (for derivative securities) are used to measure directional risk. When the value of a position depends on how different financial variables move (for instance, hedged positions), or the relationship between the position

value and the financial variable is non-linear, the exposure is to a non-directional risk. Measures of non-directional risk include volatility (for equity shares), convexity (for fixed income securities) and gamma (for derivative securities).

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2. Currency risk

Foreign currency rates fluctuate due to the changes in demand and supply and market expectations. Banks are highly exposed to forex risk because they are the major players. From a corporate viewpoint, foreign exchange risks may be divided into the following three categories:

- (i) Transaction exposure due to change in exchange rates between the date of transaction and the date of cash outflow/inflow.
- (ii) Translation exposure occurs on consolidation of financial statements of subsidiaries that are expressed in different currencies.
- (iii) Economic exposure represents threat to the core business model when there is competition with imported products in the domestic market.

3. Interest rate risk

Interest rate risk arises due to asset liability mismatch. Assets in banks are generally short-term while liabilities are long term. When interest rates increase, banks cannot deploy funds at higher rates. If the liabilities are short-term and the interest rates increase, banks' net margin decreases.

4. Commodity risk

Commodity risk arises from potential movements in the value of commodity contracts, which include agricultural products, metals, and energy products.

8.4.2 Liquidity Risk

The two types of liquidity risks have been discussed as follows:

- (i) **Funding liquidity risk** is the inability to raise funds at normal cost. Banks face lack of liquidity sometimes due to the necessity to meet obligations or to meet unexpected cash outflows or due to drying up of unexpected inflows. An institution might lose liquidity if its credit rating falls or there are sudden cash outflows.
- (ii) **Trading-related liquidity risk** is the risk that an institution will not be able to execute a transaction at the prevailing market prices. It occurs due to lack of trading depth in the market for a security or class of assets. If the transaction cannot be delayed, its execution may lead to a substantial loss.

Liquidity risk tends to aggravate other risks. If a securities trading organization has a position in an illiquid asset, it will find it difficult to liquidate that position at short

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notice. This will compound its market risk. Liquidity risk can also aggravate credit risk if a firm has to default due to default of a counter party. Certain techniques of asset liability management (ALM), such as liquidity gap analysis, can be used to assess liquidity risks.

8.4.3 Credit Risk

Credit risk is also known as default risk and it is the risk that the other party may be unwilling or unable to fulfill its contractual obligation. Losses due to credit risk can occur before the actual default due to changes in the credit rating of the counterparties. Credit risk also includes sovereign risk. This occurs when countries impose foreign-exchange controls that make it impossible for counterparties to honour their obligations.

One particular form of credit risk is settlement risk, which occurs when two payments are exchanged on the same date. This risk arises when the firm has already made its payment and the other party may not be able to pay. The risk is the entire value of the counterparty's obligation. Settlement risk is a bigger risk in foreign exchange markets. In contrast, pre-settlement risk is the netted value of the two payments.

8.4.4 Operational Risk

Operational risk is the risk arising out of failed internal processes, people and systems or from external events. Risks arising from failed internal processes include accounting errors, reporting errors, valuation errors and transaction errors.

Risks arising from failed internal people include employee collusion and fraud, lack of knowledge and skill, employee errors and loss of key personnel. Risks arising from failed internal systems include lack of data quality, programming errors, security breaches, system failures and lack of system suitability. External risk factors include political, legal and regulatory factors, natural disasters, theft and terrorist activities.

8.4.5 Need and Benefits of Risk Management

The goal of a modern corporation is to maximize the wealth of its shareholders that is consistent with their risk preference. Risks, therefore, have to be managed effectively while ensuring achievement of the desired returns. Increasing volatility in financial markets and increasing use of leverage (using derivatives) make risk management still more important.

Risk management does not, however, imply avoidance of risk. Taking reasonable and well-understood risks is necessary to earn good returns. A firm must, therefore, establish sound policies and procedures to identify,

measure, monitor and control risk. Risk management leads to the following benefits for a firm:

- Enables quantification of risk
- Helps identify extremely risky situations
- Improves risk awareness
- Enables performance measurement on the risk-adjusted basis
- Reduces earnings volatility
- Maximizes shareholders' value
- Promotes job and financial security

Project Appraisal

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Check Your Progress

4. What are business risks?
5. Give examples of strategic risk.
6. What are the types of marketing risk?
7. What are the measures of non-directional risk?
8. What are the two types of liquidity risk?
9. What is operational risk?

8.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. There are three steps in the process of risk management. The first step is the identification of potential losses. The second step involves identification of potential losses and the third step involves selection of appropriate technique for treating loss exposure.
2. Techniques available for handling loss exposure include avoidance, loss control, retention, non-insurance transfers and insurance.
3. Two major components of loss control are loss prevention and loss reduction.
4. Business risks are risks that a firm willingly assumes as a part of its business activities. They relate to the product market in which the firm operates. They arise due to technological, competitive and consumer-related factors.
5. Expropriation and nationalization are examples of strategic risks.
6. Marketing risks can be classified into Price risk, currency risk, interest rate risk and commodity risk.
7. Measures of non-directional risk include volatility (for equity shares), convexity (for fixed income securities) and gamma (for derivative securities).

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8. The two types of liquidity risks are funding liquidity risk and trading-related liquidity risk.
9. Operational risk is the risk arising out of failed internal processes, people and systems or from external events.

8.6 SUMMARY

- A suitable classification of projects gives a solid logic for building a system for effective decision-making.
- There are three steps in the process of risk management. The first step is the identification of potential losses. The second step involves identification of potential losses and the third step involves selection of appropriate technique for treating loss exposure.
- Techniques available for handling loss exposure include avoidance, loss control, retention, non-insurance transfers and insurance.
- Firms are exposed to various types of risks. These can be broadly classified into business risk, non-business risks and financial risks.
- Business risks are risks that a firm willingly assumes as a part of its business activities. They relate to the product market in which the firm operates. They arise due to technological, competitive and consumer-related factors.
- Non-business risks are the risks over which firms have no control. They include strategic risks and financial risks. Strategic risks result from fundamental shifts in the economy or political environment. Expropriation and nationalization are examples of such risks. Financial risks relate to possible losses in financial markets, such as losses due to changes in interest rates or defaults on financial obligations by counterparties.
- Financial risks can be divided into market risk, credit risk and operational risk.
- Market risk arises due to movement in financial variables such as security prices, interest rates, foreign exchange rates and commodity prices. The risk is that of fluctuations in portfolio value due to changes in these financial variables. Market risks can be further classified into: Price risk, currency risk, interest rate risk and commodity risk.
- Price risk arises due to unfavourable movement in the prices of securities or other obligations. Price risk is also very important for an investment institution. It has a different impact on short (sale) and long (purchase) positions. The various types of price risks are:
 - o Symmetrical and non-symmetrical risk
 - o Absolute and relative risk
 - o Directional and non-directional risk

- Foreign currency rates fluctuate due to the changes in demand and supply and market expectations. Banks are highly exposed to forex risk because they are the major players.
- Interest rate risk arises due to asset liability mismatch. Assets in banks are generally short-term while liabilities are long term. When interest rates increase, banks cannot deploy funds at higher rates. If the liabilities are short-term and the interest rates increase, banks' net margin decreases.
- Commodity risk arises from potential movements in the value of commodity contracts, which include agricultural products, metals, and energy products.
- The two types of liquidity risks are funding liquidity risk and trading-related liquidity risk. Funding liquidity risk is the inability to raise funds at normal cost. Trading-related liquidity risk is the risk that an institution will not be able to execute a transaction at the prevailing market prices.
- Credit risk is also known as default risk and it is the risk that the other party may be unwilling or unable to fulfil its contractual obligation. Losses due to credit risk can occur before the actual default due to changes in the credit rating of the counterparties.
- Operational risk is the risk arising out of failed internal processes, people and systems or from external events. Risks arising from failed internal processes include accounting errors, reporting errors, valuation errors and transaction errors.
- Risk management does not imply avoidance of risk. Taking reasonable and well-understood risks is necessary to earn good returns. A firm must, therefore, establish sound policies and procedures to identify, measure, monitor and control risk.

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8.7 KEY WORDS

- **Business risks:** These are risks that a firm willingly assumes as a part of its business activities. They relate to the product market in which the firm operates.
- **Non-business risks:** These are the risks over which firms have no control. They include strategic risks and financial risks.
- **Credit risk:** It is the risk that the other party may be unwilling or unable to fulfil its contractual obligation.
- **Operational risk:** It is the risk arising out of failed internal processes, people and systems or from external events.

8.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What do you mean by risk retention?
2. Differentiate between symmetrical risk and non-symmetrical risk?
3. What is absolute risk?
4. What are the three categories into which currency risk may be divided?
5. Write a short note on the benefits of risk management.

Long-Answer Questions

1. Discuss the sources of information used for identifying potential losses.
2. Explain the various types of risks.
3. Discuss in detail marketing risk and its classifications.

8.9 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
- Mohanty, S.K. 2005. *Fundamentals of Entrepreneurship*. New Delhi: Prentice Hall of India.
- Desai, Vasant. 1997. *Management of Small Scale Industries*. New Delhi: Himalayan Publishing House.
- Kumar, S. Anil. 2008. *Entrepreneurship Development*. New Delhi: New Age International.

BLOCK - III

PROJECT AND ECONOMIC DEVELOPMENT

Project Report

UNIT 9 PROJECT REPORT

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Structure

- 9.0 Introduction
- 9.1 Objectives
- 9.2 Meaning and Purpose of Project Report
- 9.3 Formulation of Business Plan
 - 9.3.1 Characteristics of a Successful Business Plan
- 9.4 Answers to Check Your Progress Questions
- 9.5 Summary
- 9.6 Key Words
- 9.7 Self Assessment Questions and Exercises
- 9.8 Further Readings

9.0 INTRODUCTION

The preparation of a project report and a business plan is crucial to the progress of any business. A project completion report is prepared at the end of a project review. It comprises information such as project description, Pre-construction information, Physical construction information, analysis of cost variance, and a brief report. A project report is usually detailed and informative. This unit will discuss the components of a project report. The components of a business plan will also be detailed. A business plan should be comprehensive and constantly updated according to the changes in circumstances. This unit will also delve into the characteristics of a good business plan.

9.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the meaning and purpose of project report
- Discuss the content of a business plan
- Examine the characteristics of a good business plan

9.2 MEANING AND PURPOSE OF PROJECT REPORT

Once the project is terminated and handed over to the operations team, project review is undertaken. The end result of project review is the preparation of the

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project completion report (PCR). Project completion report is a document which would give a comparison of the actual costs and the time with the originally budgeted ones. The reasons for deviations are recorded. The initial scope and the level of its attainment are also documented with observations upon them. The degree of attainment of goal is also recorded in the project completion report. It is usually quite detailed and informative.

Contents of Project Completion Report

The contents of a post-completion report may vary depending upon the type of project and the perceived benefits from project review activity. The European Commission uses 'Seven-Framework-Program' for technical review of a project.

You may find several web resources if you search for 'project review template' on Google.

The following is a sample project completion report format used by a public sector company:

This report is called 'completion report'. It is in five parts, namely

E-1: Project Description

E-2: Pre-Construction Information

E-3: Physical Construction Information

E-4: Analysis of Cost Variance

E-5: Brief Narration Report

The format of each part is given as follows:

E-1: Project Description

(To be submitted: 1 year after the start of commercial production)

Sr. No.	Item	As per original feasibility report/project report sanctions	As per latest revised sanction, if any	Actual/anticipated	Remarks
1	2	3	4	5	6

1. Major plants and their installed capacity
2. Major products/outputs and their installed capacity
3. Construction and gestation period
 - 3.1 Date of start of construction
 - 3.2 Date of completion (Mechanical)
 - 3.3 Date of feed-in/start of trial run
 - 3.4 Date of commercial production
 - 3.5 Date of achievement of capacity of
 - (a) 50%
 - (b) 60%
 - (c) 80%

(d) 90%

(e) 100%

4. Total cost (after completion)

4.1 Rupees (total)

4.1.1 Civil works

4.1.2 Plant & Machinery

4.1.3 Others

4.2 Foreign exchange component

4.3 Cost incurred so far

4.4 Date of closing of capital account

4.5 Year to which cost estimate relates

5. Phasing of expenditure (from start of the project construction)

Year _____

6. Project profitability

6.1 Sales price per unit for major products

6.2 Ex-factory cost per unit of major products

6.3 Economic life of plant

6.4 Financial rate of return at _____% capacity until

6.5 I.R.R. (financial)

6.6 Capital-output ratio

6.7 Return on capital employed

7. 7.1 Total capital employed

7.2 Net fixed capital

7.3 Working capital

7.4 Equity and reserves

7.5 Long-term loans

8. Employment: A. During construction

8.1 Technical, managerial and professional

8.2 Clerical and staff

8.3 Skilled

8.4 Unskilled

8.5 Daily wage/casual/work charged

B. During operation

8.6 Technical, managerial and professional

8.7 Clerical and staff

8.8 Skilled

8.9 Unskilled

8.10 Capital-labour ratio

9. Project inter-linkages (During construction)

9.1 Forward linked project (s) Name _____ commissioning date

9.2 Backward linked project(s) Name _____ commissioning date

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E-2: Pre-Construction Information

(To be submitted one year after the start of commercial production)

Name of Project: _____

Nature-Expansion/New Project

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Sr. No.	Item	Date (Month, Year)			Delay	Major Reasons
		Original Scheduled/ Target	Latest Revised	Actual		
1	2	3	4	5	6	7

1. Proposal to set up the project
2. Feasibility study report
 - 2.1 Decision to undertake feasibility study
 - 2.2 Appointment of consultants/agencies
 - 2.3 Start of report
 - 2.4 Report completion
 - 2.5 Report submission to government
3. Government approval
 - 3.1 PIB/IFC approval
 - 3.2 Government approval
4. Technical collaboration
(Name _____)
(Separately for Indian, foreign)
 - 4.1 Application for collaborations
 - 4.2 Approval for collaboration
5. Credit tie-up
(Name _____)
 - 5.1 Application
 - 5.2 Approval
6. Consultant/know-how/adviser
(Name _____)
 - 6.1 Invitation of bids/tenders
 - 6.2 Decision/selection
 - 6.3 Consultant/adviser in position
7. Land acquisition
 - 7.1 Application
 - 7.2 Permission
 - 7.3 Start of land acquisition
 - 7.4 Completion of land acquisition
8. Compulsory registration
9. Appointment of chief executive
10. Detailed project report/revised cost estimates
 - 10.1 Submission
 - 10.2 PIB/EEF approval
 - 10.3 Government approval

11. Start of construction work at site

Project Report

E-3: Physical Construction Information

(To be submitted 1 year after the start of commercial production)

Name of Project:

A. Revision of Project Schedules

Sr. No.	Date	Technique used	Date of commissioning	Total project duration	Reasons for revision

(First schedule will be as given in the feasibility report)

B. Completion of Major Project Activities

Activity	Duration (Books)		Date of completion of activity			Reasons of variation
	As per original schedule	Actually achieved	As per original schedule	As per latest revised schedule	Actual	
2	3	4	5	6	7	8

1. Land development
2. Design and engineering
3. Construction of plants - for each plant (Main/auxiliary)
 - 3.1 Drawings
 - 3.2 Civil works
 - 3.3 Procurement of equipment
 - 3.4 Erection
 - 3.5 Testing and commissioning
4. Utilities and services
 - 4.1 Roads
 - 4.2 Railway sidings
 - 4.3 Water supply
 - 4.4 Water treatment plant
 - 4.5 Power installations
 - 4.6 Sewerage
 - 4.7 Storm water drainage
 - 4.8 Effluent treatment
5. Non-plant buildings
6. Township
 - 6.1 Land development
 - 6.2 Residential buildings
 - 6.3 Non-residential

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7. Total project

E-4: Analysis of Cost Variation

(To be submitted one year after the start of commercial production)

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Name of Project:

A. Revision of Cost Estimates (Total Production)

Sr. no.	Date of estimation	Cost estimated		Date of approval	Cost approved		Major reasons for variation
		Total ₹	FE		Total ₹	FE	

(First item will correspond to cost estimate given in feasibility report)

B. Details of Variations between Originally Sanctioned and Actual Costs Estimates

Sr. no.	Cost item	Cost as per Or. Sanction		Actual/ anticipated cost		Amount of variation due to						
		S	E	₹	FE	Cost as per original sanction	No provision	Price rise	Increase in duties/ taxes	Change in scope	Delays	Other reasons (Specify)
1	2	3	4	5	6	7	8	9	10	11	12	13

1. Preliminary expenses
2. Land
3. Design and engineering
 - 3.1 Civil works
 - 3.2 Structural works
4. Major items:
 - 4.1 Plant and machinery
 - 4.2 Erection charges
5. Main items
6. Utilities and services
7. Township
8. Constancy
9. Project management
10. Interest charges
11. Pre-production expenses
12. Margin money for working capital
13. Others (Specify)
14. Total

C. Details of Variation between the Latest Revised Estimates and the Actual Costs

Sr. No.	Cost item	Cost as per revision sanction		Actual/ anticipated cost		Amount of variation due to						
		₹	E	₹	FE	Inadequate provision	No provision	Price rise	Increase in duties/ taxes	Change in scope	Delays	Other reasons (Specify)
1	2	3	4	5	6	7	8	9	10	11	12	13

1. Preliminary expenses
2. Land
3. Design and Engineering
 - 3.1 Civil works
 - 3.2 Structural works
4. Major items:
 - 4.1 Plant and machinery
 - 4.2 Erection charges
5. Major items
6. Utilities and services
7. Township
8. Constancy
9. Project management
10. Interest charges
11. Pre-production expenses
12. Margin money for working capital
13. Others (Specify)
14. Total

Note: In statements B and C, the detailed cost items as may be applicable, should be given separately for each project component/plant for which separate provisions exists in the sanctioned cost estimates.

E-5: Brief Narration on Report

Name of project:

1. Introduction, project history and importance
2. Agencies involved
3. Project highlights
4. Foreign collaboration/assistance
5. Implementation achievements and failures
6. Problems experienced
7. Suggestions for future projects
8. Any other qualitative observations

A project report has another purpose also; getting funds for financing the project. If funds are raised through the public issue of shares or bonds then the firm is required to prepare the 'prospectus' as per the rules of Securities and Exchange Board of India (SEBI), get it approved and then approach the public. The contents of the prospectus and the procedure are prescribed by SEBI. The contents are adequate for an investor to make a judgement about the viability of the project and safety of their investment.

However, if funds are sought from the financial institutions then the firm has to provide a project report in the format prescribed by the financial institution. The

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financial institution will use the project report for the appraisal before deciding whether to finance the project or not and at what rate.

Contents of Project Report for Financial Institutions

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Study of forms prescribed by various financial institutions indicates that all of them want some common information. The most important information contained in the project report for financing purposes are as follows:

• Market information

The project report will contain information helpful in assessing the market potential. Some important market information will include demand-supply gap analysis. The demand-supply gap analysis is based on projections by industry association, estimates by the planning commission and market reports by independent analysts. The project report will also give a complete marketing strategy, distribution network and details of key marketing personnel.

• Technical information

Important technical information will include product mix, capacity, technology and technical know-how, technical collaborations, raw material and their sources, important consumables, location, site details, details of plant and equipments, details of buildings, manpower requirement and assessment regarding its availability, costs estimates, break-even point, etc.

• Financial information

The financial information will include the finance plan, cost of capital calculation and projected financial statements including income statement, balance sheets and cash flow statements, and calculation of key ratios like interest cover ratio, debt-service cover ratio, the internal rate of return and the accounting rate of return. The management contribution in capital and participation of large individual and institutional investors in equity are also the important financial information in the project report for financing. Cost and revenue-related assumptions also form a part of the project report.

• Economic appraisal

The applicant firm is required to conduct the economic analysis of the project and include it in the project report.

• Environment appraisal

If the project is subject to a mandatory environment appraisal then the report of the environment appraisal must be included in the project report. Otherwise, some satisfactory statements such as evidence that the project meets all criteria for

pollution control, waste treatment and other issues of environmental concerns should be provided.

Project Report

- **Management information**

Information about the promoters and senior management team, their experience and affiliations along with the data on potential conflict of interest must be included in the project report.

- **What-if analysis**

Several financial institutions require the applicant firms to provide a what-if analysis (sensitivity analysis), especially for a large project and from a large firm.

Check Your Progress

1. Define project completion report.
2. What kind of technical information is included in a project report?

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9.3 FORMULATION OF BUSINESS PLAN

The business plan must be comprehensive. The management and organizers of the institution must carry out in-depth planning and then prepare the business plan. Economic conditions, competition, customer base and market demand must be accurately forecasted by it. Sound banking principles must be reflected in the plan along with a demonstration of realistic risk evaluation in the face of competitive and economic conditions in the target market.

The chief argument in favour of preparing a business plan is that it convinces the entrepreneur that his dream or idea can be turned into a real operating business enterprise. The entrepreneur must refrain from trying to sell his plan unless he is satisfied that it ‘makes sense’. Only after being fully convinced that the idea will work, it should be shown to prospective investors and lenders. Business plans are not ‘one-time’ documents meant only to obtain finance or attract investors. They are ‘living’ documents in the sense that they need to be updated and upgraded from time and again as circumstances vary and corresponding alterations have to be made to the business.

Unless a person has enough funds for investing in his business, a business plan is needed for convincing investors and lenders that the business is worth investing in. The business plan can also function as a blueprint for the business. The methods of preparing a business plan have seen several changes. In the modern era, the Internet (for example, such services are offered by Planigent) has become a big source for aspiring entrepreneurs to prepare their business plans.

Institutions with particular purposes or aims (such as bankers’ banks, cash management, trust only or credit cards) must discuss that particular distinct or

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special feature in a detailed manner in the suitable section of the plan. Three years must be covered in the business plan, which must explain in detail the activities that the entrepreneur proposes to engage in for accomplishing the enterprise's chief functions. It must be demonstrated in the description that the enterprise has sufficient capital for supporting the risk profile, it can operate safely and that it stands a fair chance of success. All institutions that make use of the Internet or alternative electronic delivery channels, the market that will be served by the enterprise and the services and products that will be offered via the electronic channels must be clearly defined in the plan. Given that a global market exists for the Internet and it can reach everyone with access to the Net, selected details regarding services and products and market are vital. The manner in which brand recognition will be attained by the enterprise should be explained in the marketing plan.

The business plan serves the following purposes:

- Under many crucial aspects of the venture, business plan ensures that the entrepreneur will do the business in a thoughtful manner.
- Business Plan allows the entrepreneur to embed his goals into the objectives and to achieve them in a logical and structured manner.
- The entrepreneur can plot his progress vis-à-vis the plan.
- The business plan can identify the time and financial requirements of the business.
- Assuming that the key features of the business plan are communicated to the employees, the business plan is a means to make them cognizant of the direction the business proposes to take.
- In case the aim of the management is turning around a business or starting a new stage of growth, the business plans becomes a significant instrument of articulating its ideas even as investors and other people are convinced to support it.
- It serves as a vital document to be used in discussions with potential lenders and investors of funds such as venture capitalists and banks.
- It links the detailed, short-term and annual budgets.

Therefore, the business plan should provide a complete framework for the presentation of all information that would be required by financial institutions for appraising the business. It would also enable the entrepreneur to know how much money, material and manpower would be required to set up the business. Thus, a business report for an entrepreneur is very similar to a guide map for a traveller.

The actual worth of the creation of a business plan lies in systematically researching and thinking about one's business instead of in having the finished product in hand. The act of planning aids an entrepreneur thinking things through, studying and researching, and looking at his schemes from a critical perspective. Although this is time consuming, it is nevertheless useful in avoiding expensive and maybe even catastrophic blunders later.

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It serves as a general model that suits every type of business. But it needs to be modified by every entrepreneur in keeping with his specific circumstance. As such, certain areas are emphasized in the business plan according to the type of business (service, retail, manufacturing, etc.) that is undertaken. It further offers some tips to enable the entrepreneur to fine-tune his plan so that an effective presentation can be made to the bankers or investors. In case this is the objective behind the creation of the plan, then special attention needs to be paid by the entrepreneur to the style of writing. It is both his ideas as well as the appearance and quality of his work that are the criteria for judgement.

Usually, several weeks are required for a good plan to be completed. The majority of that time is expended in researching and re-thinking one's assumptions and ideas, which is where the real worth of the process lies. In addition, the entrepreneur should take and preserve detailed notes on the assumptions that underlie his financial data as well as his sources of information.

Components of a business plan

The components of a business plan are as follows (Figure 9.1):

1. Estimation
2. Projection
5. Information
4. Calculations
5. Documentation

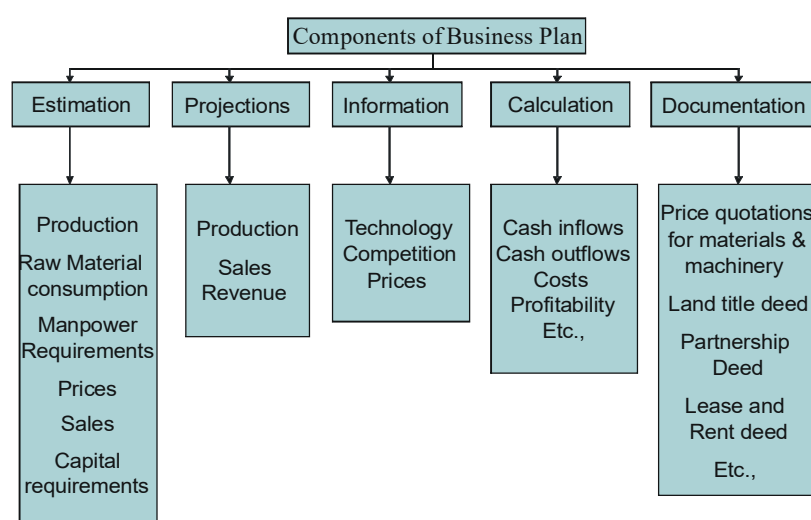


Fig. 9.1 Components of a Business Plan

A business plan should estimate the production demand, raw material consumption, manpower requirements and capital requirements in terms of value of money. It should also estimate the prices of product and sales. The plan has to

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project the cost of production and sales revenue to determine the feasibility of the plan. Adequate information regarding technology, competition and prices must be available so as to adopt the suitable technology based on the competitive products technology, investment ability of company and pricing of technology. An organization works with the motive of making profits. The business plan has a component about the cash inflow, cash outflow, and cost of product and profitability. A study of all these is essential for an entrepreneur to have an understanding about the safety of his investment. Apart from this, a business plan should concentrate on flow of work in the organization by making proper documentation on price quotations for materials and machinery, land title deed, lease and rent deed and it should also stress on the legal aspects related to business, such as partnerships. According to Partnership Act, 1932, a Partnership Deed should be prepared and registered. The components of a business plan guide the preparation of a comprehensive plan.

Contents of a business plan

A business plan may be prepared in different ways by different entrepreneurs. There is no standard pattern for it. However, it must contain all information necessary to appraise it and for lending institutions to take a financial decision. The amount of information to be furnished in the report depends upon the size of the unit, the nature of production and the amount of finance required. The Planning Commission of India has issued certain guidelines for formulating a business plan for industrial concerns. These guidelines are more or less similar to the one which you are going to learn now. However, the various headings of those guidelines are as follows:

- General information
- Preliminary analysis of alternatives
- Project description
- Marketing plan
- Capital requirements and costs
- Operating requirements and costs
- Financial analysis
- Economic analysis

The following guidelines will help an entrepreneur to prepare a business plan for the establishment of a small-scale unit. The relevant information should be given under the following heads:

- General company description
- Products and services
- Marketing plan
- Operational plan
- Management and organization

- Personal financial statement
- Startup expenses and capitalization
- Financial plan
- Economic and social considerations

A business plan starts with the owner's particulars such as address and phone numbers and an executive summary, which explains the fundamental aspects of the business, such as what the product is, who the customers are, who the owners are, what can be the future potential of the industry in general and the business in particular, and so on. It should be concise, complete, professional and enthusiastic. If a loan is being applied for, the amount that is required should be clearly stated along with a description of how the entrepreneur plans on using it and how the loan amount can aid in making the business more profitable and consequently ensure that the money will be repaid.

General Company Description

To start with, some basic information should be provided. This includes:

- **Basic questions:** Questions such as 'What will I do?' and 'What business will I be in' should be asked and answered by the entrepreneur.
- **Mission statement:** A number of businesses usually add a short mission statement of about thirty words to the plan, which explains the principles that are intended to guide the business and the very reason behind the existence of the business. In case an entrepreneur wants to have a mission statement drafted, this is where it can be inserted in the plan.
- **Company goals and objectives:** The mission statement is followed by a list of company objectives and goals. Goals specify the destination that the entrepreneur aspires to reach and objectives mark the progress along the way. For instance, if the goal is to have a successful and healthy organization that is the best in customer service and is assured of a loyal customer base, the objective would be certain customer satisfaction measures and the annual sales figures.
- **Business philosophy:** What is given the maximum importance by the entrepreneur in the business?
- **Whom will the entrepreneur's products be marketed to:** (This is stated briefly here, as it will be explained in a more detailed manner in the section on Marketing Plan).
- **Description of the industry:** Is it a growth industry? What changes does the entrepreneur foresee in the industry, both short term and long term? How will the company be poised to take advantage of them?
- **Description of the most significant strengths and core competencies of the company:** What kind of strengths, skills, experience and background are personally brought by the entrepreneur to this new project? What will be the business' major competitive strengths? What are the factors that could lead the company to success?

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- **Legal form of ownership:** Is the company a Limited Liability Corporation (LLC) a corporation, a partnership, or a sole proprietor firm? Why was this particular form selected by the entrepreneur?
- **Personal profile of the entrepreneur:** The entrepreneur's name and address as well as his capabilities, experience and qualification.

Products and Services

In this section of the business plan, the entrepreneur projects his ideas about the products or services that he is going to launch and why he has chosen them. This section does not focus on the unique features and benefits of each product or service. These are assessed in the section on 'Market Plan'. The following are the key areas of study:

- The entrepreneur describes his services or products.
- He states the factors that are likely to offer him some competitive advantage or disadvantage such as some distinct or proprietary feature, the level of quality, and so on.
- He states the leasing structures, the fee or the pricing of his services and products.

Marketing Plan

A marketing plan helps an entrepreneur answer the questions of how to market his products or services. Why a marketing plan? How does one make a marketing plan? Answers to these questions are provided in this section.

Regardless of how good one's products or services are, the project cannot meet with success in the absence of effective marketing, and the entrepreneur must begin this process by carefully and systematically researching the market. It is foolhardy to assume that an entrepreneur already has adequate knowledge of his intended market. Market research needs to be conducted by the entrepreneur for ensuring that he is on the right track. He can utilize the process of business planning for obtaining data and planning his marketing endeavours.

Market research can be of two kinds: primary and secondary. The former refers to the collection of one's own data. For instance, doing one's own traffic count at a planned site, using the yellow pages for identifying competitors, and conducting focus-group interviews or surveys for obtaining information regarding consumer preferences. Professional market research can be a rather expensive affair; however, a number of books are available on how owners of small businesses can conduct effective research themselves. Small business aspirants can meet fellow entrepreneurs, a customers or suppliers and give questionnaires to them to seek the required information to launch a business.

Secondary research refers to the use of published information such as demographic profiles, census data, magazines, newspapers, trade journals and industry profiles. Such information can be obtained from government agencies, vendors to the proposed type of industry, chambers of commerce, industry associations and public libraries.

An entrepreneur can start at the local library and review its business data collection. There are innumerable online sources that can also be used. A chamber of commerce can provide good local area information. Trade publications frequently provide superior industry-specific data.

It is necessary for the entrepreneur to be as specific as possible in the marketing plan and provide sources, numbers and statistics. This is important as, at a later date, crucial sales projections will be based on the marketing plan. In case he is an existing entrepreneur and wants to enlarge or diversify the following must also be included in the business plan under the Marketing Plan section.

Economics

The entrepreneur makes an assessment of the economic activity of the existing company and furnishes facts about his industry.

He considers the following issues:

- Total size of the market, the geographical area that is covered and the quantity of sales
- Percentage of market share that he will have (this assumes importance only if he expects to be a key force in the market.)
- Current demand in the target market. In other words, the quality and quantity that the target customer expects from the entrepreneur with regard to the product
- Trends in the target market such as product development, consumer preferences and growth trends
- Opportunities and growth potential for his size of business
- Hurdles that might be faced by the firm when it enters a market are location problems (problems in acquiring the prime area in the market for services), quotas and tariff barriers, shipping costs, unions, distinct technologies and patents, skills and training, brand recognition and consumer acceptance, and high marketing, production and high capital costs.
- The manner in which these hurdles can be overcome by means of some constructive scheme or plan
- The manner in which the company may be affected by alterations in the industry, economy, government regulations or technology

Analysis of unique features and benefits of product and services

The intention of this exercise is to identify the important and unique features of his product or service.

- The entrepreneur lists all his key services and products.
- The most significant features are described along with an explanation of what is so special about them.
- The benefits are described in addition to an explanation of what the product is expected to do for the customer.

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The entrepreneur describes the after-sales services that he will provide, such as refunds, follow-ups, service contracts, warranties and delivery.

Customers

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The customer section of a business plan includes customer details in terms of geographic and demographic factors and focuses on customer profile in order to build customer loyalty.

The targeted customers are identified by the entrepreneur along with their geographic locations and characteristics (this is called demographics). Based on whether the target customers are direct consumers or other businesses, the descriptions are likely to be absolutely different. If a consumer product is to be sold via retailers, wholesalers or distribution channels, both the middleman as well as the end consumer need to be analysed. There may be more than one customer groups, in which case, the most important groups need to be identified. Following this, a demographic profile has to be constructed for every consumer group, consisting of education, occupation, social class, level of income, location, gender, age and other details pertaining to his industry. Similarly, in the case of business customers, the demographic factors could include price preferences, technology, quality, size of the company, location, industry and other details pertaining to his industry.

Competition

In this section of business plan, a complete competitor strategy and competitive analysis have to be made to learn about competitive products and competitors' strengths, weaknesses, opportunities and threats.

- The firms and products that may prove to be competition for the entrepreneur
- The names and addresses of key competitors
- Are they expected to compete only for specific locations, customers and products, or across the board?
- Is there likely to be significant indirect competition (e.g., the competition between theatres and video rental stores, even though they engage in different types of business)?
- How are his services or products likely to compare with those of competitors?

The competitive analysis format shown in Table 9.1 can be used by the entrepreneur for comparing his firm with his two most significant rivals. The major competitive factors are listed in the first column. Since there is variation among them across the industry, this list of factors may be customized.

In the column labelled **Me**, an honest evaluation of how the entrepreneur thinks he might be received in the customers' mind is stated. He then checks whether this factor would prove to be a weakness or strength for him. At times, it may be difficult to analyse one's own weaknesses. Honesty is important here. In

fact, an unbiased third person might make a better assessment of you. The entrepreneur must understand that he cannot be all things to all people. Actually, such an attempt could lead to failure in business as efforts could get diluted and scattered. The entrepreneur should prefer an honest evaluation of his company's strengths and weaknesses.

The next step is to analyse every significant rival he has. His analysis of how they compare to his firm is briefly stated by him.

In the last column, an estimate of the significance that every competitive factor holds for the customer is given. 1 = *critical*; 5 = *not very important*.

Table 9.1 Competitive Analysis

Factor	Me	Strength	Weakness	Competitor A	Competitor B	Importance to Customer
Products						
Price						
Quality						
Selection						
Service						
Reliability						
Stability						
Expertise						
Company Reputation						
Location						
Appearance						
Sales Method						
Credit Policies						
Advertising						
Image						

Niche

Under this section, the entrepreneur studies his product's unique position in the market.

Following the systematic analysis of the industry, competition, customers and products, a clear picture should have emerged about where the firm stands. A

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short description of his definition of his unique position—his niche—should be provided. Following this, a strategy that is consistent with this niche is formulated.

Promotion

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In this section, the plan describes how the entrepreneur plans on communicating his presence to the customers.

Advertising: Questions such as what media is to be chosen, how often and why, why has this particular mix been chosen instead of some other mix, have low-cost methods been identified for getting the most out of the promotional budget, will methods other than paid advertising (e.g., word-of-mouth, dealer incentives, catalogues, trade shows, etc.) be used, what kind of image does the entrepreneur wish to present and how does he expect the customer to view him, are considered. Additionally, the entrepreneur must look into options for graphic image support, including interior designing (only in cases where customers visit his place of business), signage, brochures, letterheads, cards, logos, etc. He must also consider whether some system should be installed for identifying repeat customers so that they can be systematically contacted.

Promotional Budget: Here, the amount that can be spent on the items discussed above is considered, prior to starting up (which will be included in the start-up budget) as well as when the business operations are being carried out (which will be included in his operating plan budget).

Pricing

Under this section, the methods for setting the price are explained. With the majority of small businesses, the lowest price may not necessarily be the best policy as it may reduce the profit margin and customers might not be bothered with the price. In any case, they may be under-priced by larger rival firms. Generally, average prices, coupled with a competitive level of quality, are preferable. It is also necessary to consider whether the pricing strategy fits in with what the competitive analysis had revealed. Further, the prices need to be compared with those of rivals and some analysis needs to be done regarding whether they are higher/lower, and if so, then why. The entrepreneur must also examine the degree of importance of price as a competitive factor to see whether customer buying decisions are really affected by the price, and if so, then to what extent. In addition, he must look into the credit policies and customer services that he wishes to provide.

Proposed location

The entrepreneur may not have decided on an exact location yet for setting up his business enterprise. This is the point at which he must think about what exactly is required from the location. Numerous start-up ventures can be successfully run from homes, at least temporarily. The physical requirements can be discussed later in the section on the operational plan. At this point, the criteria that need to be

taken into account for choosing a location are analysed in terms of their effect on the consumers. The following questions may be considered:

- Does the location carry any significance from the consumer's perspective? How so?
- Is the location convenient enough for customers to visit? Are interior spaces and parking spaces adequate? Is it accessible enough?
- Is the location consistent with the company's image?
- Does it satisfy what is wanted and expected by the customers?
- Where are the competitor's situated? Would it be better to stay close to them (e.g., fast food restaurants or car dealers) or would maintaining some distance be better (e.g., convenience food stores)?

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Distribution channels

This section focuses on product distribution in the market. Following are the different elements of distribution channel. The entrepreneur will have to adopt some of them. How are the services and products to be sold – through bids on contracts, independent representatives, agents, the sales force owned by the entrepreneur himself, agents, catalogues, the Web, mail orders, wholesalers or retailers?

Sales forecast

Having given a detailed description of the marketing plan, market, customers, services and products, the next step is to insert some statistical figures into the plan. A sales forecast spreadsheet can be used for preparing a monthly projection. Industry data (if available), the marketing strategies presented earlier in the plan as well as the company's history of sales should form the basis of this forecast.

Two forecasts may be required: a 'best guess', which is what is actually expected; and a 'worst case' scenario, which is an estimation of the target that can be reached, regardless of what may happen.

It is important for notes to be kept on the assumptions and research that goes into forecasting the sales and all the successive spreadsheets in the plan as this may have to be presented to potential funding sources.

Operational Plan

Here, the day-to-day operations of the company are explained, such as details about the environment around the company, data regarding processes as well as employees, the equipment being used, the location, and so on.

Production

Under this segment, the entrepreneur explains the methods of production and the location of the production plant.

NOTES**Methods of production process**

- Product development
- Inventory control
- Customer service
- Quality control
- Production techniques and costs

Location

Plant or factory location plays an important role in terms of nearest raw material available point, labour availability, and communication and transportation availability.

This section deals with the following study: What are an entrepreneur's requirements when selecting a location?

- Physical requirements
- Power and other utilities
- Zoning
- Type of building
- Amount of space

Access

Is it significant for the location to be conveniently accessible for suppliers? Does it have to be within walking distance? What is required in terms of parking and nearness to shipping centres, railroads, airports and freeways? A layout or drawing of the proposed facility should be included, if required (as in the case of a manufacturer), in the plan.

Construction

The majority of new enterprises must refrain from sinking their capital into construction; however, if some building work is planned, the specifications and costs must form a significant segment of the plan.

Cost

Occupation expenses such as the initial remodelling cost required for making the space suitable for his needs, insurance, utilities, maintenance costs, and rent should be estimated by the entrepreneur on the basis of the business hours, which will then form a segment of his financial plan.

Legal environment

The legal environment includes the following:

- Patents, copyrights, or trademarks (purchased, existing or pending)
- Insurance coverage

- Building code or zoning requirements
- Special regulations covering the entrepreneur's profession or industry
- Environmental, workplace and health regulations
- Permits
- Bonding and licensing requirements

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Personnel

The personnel aspects include the following:

- The use of contract workers apart from employees
- The preparation of written procedures and schedules
- Drafting job descriptions for employees. Adequate time should be taken by the entrepreneur in writing these because they can aid in internal communication with employees
- The assignment of tasks to different employees
- Training requirements and techniques
- Pay structure
- Quality of existing staff
- Where and how can the right employees be found
- Type of labour (professional, unskilled, skilled)
- Number of employees

Inventory

Inventory management is an art and in this customized and competitive environment, maintaining adequate inventory requires prioritization. In this section, the entrepreneur studies and describes the following:

- Lead-time for ordering
- Seasonal build-ups
- Rate of turnover and how this compares to industry averages
- The investment made in inventory, or the average value of the stock
- The type of inventory that needs to be kept (finished goods, supplies, raw material)

Suppliers

Here, the entrepreneur identifies the key suppliers. To avoid breakdown of production, a minimum number of suppliers is required. The following information is provided:

- Are supply costs fluctuating or stable? In case they are fluctuating, how will the shifting costs be dealt with?

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- Are short-term delivery problems or shortages expected?
- Should there be multiple suppliers for crucial items (as a backup measure)?
- History and reliability of suppliers
- Credit and delivery policies
- Type and amount of inventory furnished
- Names and addresses of suppliers

Credit policies

In this section, the entrepreneur has to answer the following:

- Does he intend to allow credit sales?
- Is there really a requirement for selling on credit? Is it usual practice in the industry and as such anticipated by clients?
- If so, what does he expect the policies to be in terms of the amount of credit to be extended and to whom?
- How is the creditworthiness of new clients to be checked?
- What are the terms that are proposed to be offered to the clients, i.e., the amount of credit and the due date for repayment?
- Will prompt payment discounts be offered? (This may be done in keeping with the industry practice)
- What would the cost of extending credit be for the entrepreneur himself? Has this cost already been built into the price?

Managing the accounts receivable

If credit is extended by the entrepreneur, an aging should be at least on a monthly basis for checking the amount that is tied up in credit so that he can be alerted to problems of slow payments. A receivables ageing looks like the following table:

	Total	Current	30 Days	60 Days	90 Days	Over 90 Days
Accounts Receivable Ageing						

Some policy is required to deal with customers who delay payments. The following questions may be considered:

- When should a phone call be made?
- When is a letter to be sent?
- When must a lawyer enter into the fray?

Managing the accounts payable

The accounts payable, that is, what is owed to suppliers, also need to be aged as it assists in planning who has to be paid and when. The payment cannot be made very early as that would reduce the cash available and it cannot be made very late as that would affect the discount he might get and also adversely affect his credit standing. In case the payment is to be delayed for certain reasons, the creditor must be informed prior to the due date. He must also keep ask whether any prompt payment discount will be offered by his proposed vendors.

The following table shows what a payables ageing looks like:

	Total	Current	30 Days	60 Days	90 Days	Over 90 Days
Accounts Payable Ageing						

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9.3.1 Characteristics of a Successful Business Plan

Here are some of the qualities of a good business plan, in order of importance:

1. It fits the business need
A good business plan fits the business need.
2. It is realistic. It can be implemented.
The second measure of good or bad in a business plan is realism. A brilliantly written, beautifully formatted, and excellently researched business plan for a product that cannot be built is not a good business plan. The plan that requires millions of dollars of investment but does not have a management team that can get that investment is not a good plan. A plan that ignores a fatal flaw is not a good plan.
3. It is specific.
Every business plan ought to include tasks, deadlines, dates, forecasts, budgets, and metrics. It is measurable.
4. It clearly defines responsibilities for implementation
A good business plan is one where one can identify every single person who will be responsible for every significant task and function.
5. It clearly identifies assumptions
This is very important because business plans are always wrong. They are done by humans, who are guessing the future, and humans guess wrong. So business plans must clearly show assumptions up front because changed assumptions ought to lead to revised plans.

6. It is communicated to the people who have to run it

A good plan is communicated. A plan can only work if people in charge have to know and understand the plan.

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Check Your Progress

3. List the components of a business plan.
4. What does the customer section of the business plan comprise?
5. What kind of information is included in the Operation plan?
6. What are key considerations while selecting a location?
7. State any two characteristics of a good business plan.
8. Why is it important for a business plan to identify assumptions?

9.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Project completion report is a document which would give a comparison of the actual costs and the time with the originally budgeted ones.
2. Important technical information will include product mix, capacity, technology and technical know-how, technical collaborations, raw material and their sources, important consumables, location, site details, details of plant and equipments, details of buildings, manpower requirement and assessment regarding its availability, costs estimates, break-even point, etc.
3. The components of a business plan are as follows:
 - (a) Estimation
 - (b) Projection
 - (c) Information
 - (d) Calculations
 - (e) Documentation
4. The customer section of the business plan include details such as customer details in terms of geographic and demographic factors and focuses on customer profile in order to build customer loyalty.
5. Operational Plan explains the day-to-day operations of the company such as details about the environment around the company, data regarding processes as well as employees, the equipment being used, the location, and so on.
6. Given below are the key considerations to keep in mind while selecting a location:
 - Physical requirements
 - Power and other utilities

- Zoning
 - Type of building
 - Amount of space
7. Here are some of the qualities of a good business plan:
- A good business plan fits the business need.
 - It is realistic. It can be implemented.
8. It is important for a business plan to identify assumptions because business plans are always wrong. They are done by humans, who are guessing the future, and humans guess wrong. So business plans must clearly show assumptions up front because changed assumptions ought to lead to revised plans.

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9.5 SUMMARY

- Once the project is terminated and handed over to the operations team, project review is undertaken. The end result of project review is the preparation of the project completion report (PCR). Project completion report is a document which would give a comparison of the actual costs and the time with the originally budgeted ones.
- The contents of a post-completion report may vary depending upon the type of project and the perceived benefits from project review activity.
- The project report of a public sector company usually has the following component:
 - o E-1: Project Description
 - o E-2: Pre-Construction Information
 - o E-3: Physical Construction Information
 - o E-4: Analysis of Cost Variance
 - o E-5: Brief Narration Report
- The project report for financing purposes includes the following information:
 - (a) Market information
 - (b) Technical information
 - (c) Financial information
 - (d) Economic appraisal
 - (e) Environment appraisal
 - (f) Management information
 - (g) What-if analysis
- The business plan must be comprehensive. The management and organizers of the institution must carry out in-depth planning and then prepare the

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business plan. Economic conditions, competition, customer base and market demand must be accurately forecasted by it. Sound banking principles must be reflected in the plan along with a demonstration of realistic risk evaluation in the face of competitive and economic conditions in the target market.

- Business plans are not ‘one-time’ documents meant only to obtain finance or attract investors. They are ‘living’ documents in the sense that they need to be updated and upgraded from time and again as circumstances vary and corresponding alterations have to be made to the business.
- The components of a business plan are as follows:
 - (a) Estimation
 - (b) Projection
 - (c) Information
 - (d) Calculations
 - (e) Documentation
- A business plan may be prepared in different ways by different entrepreneurs. However, it must contain all information necessary to appraise it and for lending institutions to take a financial decision. The amount of information to be furnished in the report depends upon the size of the unit, the nature of production and the amount of finance required.
- The relevant information of a business plan should be given under the following heads:
 - o General company description
 - o Products and services
 - o Marketing plan
 - o Operational plan
 - o Management and organization
 - o Personal financial statement
 - o Startup expenses and capitalization
 - o Financial plan
 - o Economic and social considerations
- General Company description should include basic questions, mission statement, company goals and objective, business philosophy, information regarding who the product will be marketed towards, description of the industry, description of the strengths of the company, etc.
- In the Product and Services section, the entrepreneur projects his ideas about the products or services that he is going to launch and why he has chosen them.
- A marketing plan helps an entrepreneur answer the questions of how to market his products or services. Regardless of how good one’s products

or services are, the project cannot meet with success in the absence of effective marketing, and the entrepreneur must begin this process by carefully and systematically researching the market.

- The entrepreneur makes an assessment of the economic activity of the existing company and furnishes facts about his industry.
- The customer section of a business plan includes customer details in terms of geographic and demographic factors and focuses on customer profile in order to build customer loyalty.
- In the competition section of business plan, a complete competitor strategy and competitive analysis have to be made to learn about competitive products and competitors' strengths, weaknesses, opportunities and threats.
- Under the Niche section, the entrepreneur studies his product's unique position in the market
- In the Promotion section, the business plan describes how the entrepreneur plans on communicating his presence to the customers. Promotional budget and means of advertising is decided.
- Under the Pricing section, the methods for setting the price are explained. Further, the prices need to be compared with those of rivals and some analysis needs to be done regarding whether they are higher/lower, and if so, then why.
- The Distribution channels section focuses on product distribution in the market.
- Operational Plan explains the day-to-day operations of the company such as details about the environment around the company, data regarding processes as well as employees, the equipment being used, the location, and so on.
- Under the Production segment, the entrepreneur explains the methods of production and the location of the production plant.
- Other information included in the business plan are concerned with cost, personnel, inventory management, suppliers, credit policies, etc.
- A good business plan fits the business need. It is realistic and specific. Furthermore, it defines responsibilities for implementation and identifies the assumptions. A good plan is communicated to the people who have to run it.

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9.6 KEY WORDS

- **Project completion report:** It is a document which would give a comparison of the actual costs and the time with the originally budgeted ones.

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- **Advertising:** It is a marketing tactic involving paying for space to promote a product, service, or cause.
- **Inventory management:** It is a systematic approach to sourcing, storing, and selling inventory—both raw materials (components) and finished goods (products).
- **Credit policies:** It is a set of guidelines that sets credit and payment terms for customers and establishes a clear course of action for late payments.

9.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What does the project completion report comprise?
2. Write a short note on the components of a business plan.
3. What are the two types of marketing research?
4. What are the characteristics of a good business plan?

Long-Answer Questions

1. Discuss the content of a project report prepared for financial purposes.
2. Explain the purpose of a business plan.
3. Examine the information included in a business plan.

9.8 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
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UNIT 10 ENTREPRENEURSHIP AND ECONOMIC DEVELOPMENT

*Entrepreneurship and
Economic Development*

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Structure

- 10.0 Introduction
- 10.1 Objectives
- 10.2 Role of Entrepreneur in Economic Development
- 10.3 Small Scale Entrepreneurs
 - 10.3.1 Importance and Problems of SSIs
- 10.4 Answers to Check Your Progress Questions
- 10.5 Summary
- 10.6 Key Words
- 10.7 Self Assessment Questions and Exercises
- 10.8 Further Readings

10.0 INTRODUCTION

Entrepreneurs acts as a catalyst for social change and therefore entrepreneurship is considered vital to the economic development of a country. Not only does an entrepreneur generate employment and improve the standard of living of the people, but he also plays an active role in improving the country's economic profile on the world stage. However, it is to be noted that the entrepreneurs do not operate in isolation. The government also needs to support entrepreneurs by introducing industry friendly policies. This unit will discuss the role played by small businesses globally. The importance of SSIs will be delved into, along with the problems faced by them.

10.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the importance of entrepreneurs in economic development of a country
- Discuss the role of small scale entrepreneurs
- Explain the importance, advantages and problems of SSIs

10.2 ROLE OF ENTREPRENEUR IN ECONOMIC DEVELOPMENT

The level of entrepreneurship existing in a society dictates its industrial health. A country could be backward not due to any shortage of capital or natural resources

*Self-Instructional
Material*

but because of dearth of entrepreneurial talents or a failure in tapping entrepreneurial talents that lie dormant. Historically, entrepreneurs have been seen to turn about national economies, industries and markets.

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An entrepreneur is the catalyst for social change and works for the common good. Entrepreneurship is one of the most vital inputs in economic progress of a country. The number of entrepreneurs and their proficiency affect the economic growth. The economic history of the currently well developed countries like the US, Russia and Japan supports the fact that economic progress is the result of capable entrepreneurship. The crucial and significant role played by the entrepreneurs in the economic development of advanced countries has made the people of developing and under-developed countries realize the importance of entrepreneurship for economic development. It is now an accepted fact that active and eager entrepreneurs can help in exploring the potentials of the country.

Entrepreneurship helps in the process of economic development in the following ways:

- **Employment generation:** Unemployment is one of the major roadblocks for the development of any country. It lowers 'demand' in the economy, which, in turn leads to urban/rural poverty. Entrepreneurs can help tackle unemployment by generating employment in the market both directly – self-employment – and indirectly – by starting industrial units and offering jobs to others. Thus entrepreneurship is the best way to fight the evil of unemployment.
- **Furthers capital formation:** Entrepreneurs promote capital formation as they mobilize the public's idle savings. They use both their own resources and those that they borrow for setting up their enterprises. Entrepreneurial activities of this nature are responsible for wealth creation and value addition, both of which are of prime importance for a nation's economic and industrial development.
- **Promotes balanced regional development:** Entrepreneurs play a vital role in getting rid of regional disparities with their introducing industries in regions that are backward or less developed. With these industries, the regions get many public benefits such as entertainment, education, health, transport and roads.
- **Improved living standards:** A rise in the standard of living of the citizens shows that a nation's economy is on the path of growth and the nation is economically developing. Entrepreneurs are players in raising the people's standard of living by adopting new innovations in the production of the wide variety of goods and services on a large scale and at lowest possible cost. This allows people to obtain better quality goods at lower prices, resulting in a better living standard.
- **Improvement in country's economic profile on the global stage:** Successful entrepreneurs have contributed immensely in the improvement

of country's economic profile on the world stage. Entrepreneurs like the late Dhirubhai Ambani, Narayan Murthy and Kiran Mazumdar Shaw have contributed immensely in raising India's economic reputation on the world stage.

- **Creating innovation:** An entrepreneur is a person who is always looking for changes. Not only does he combine the factors of production, he also introduces new ideas and new combination of factors. He always tries to introduce new techniques of production of goods and services. An entrepreneur brings economic development through innovation.

We can now conclude that entrepreneurship and economic development are intimately related. Whatever be the form of economic and political set-up of the country, entrepreneurship is indispensable for economic development.

However, entrepreneurs alone cannot drive the economic growth of the country. They will need the active support of the government through industry friendly policies and regulations. It is important to note that level of entrepreneurship will stagnate in the country if the government continues to remain apathetic to the demands of entrepreneurs.

The government can help entrepreneurs in the following ways:

- **Availability of capital:** Many entrepreneurs face problems in raising capital for their business. Capital is the important aspect of entrepreneurship, without which no business can start or survive. So, it is moral responsibility of the state and central government to make cheap capitals available for the entrepreneurs.
- **Special help to the small scale entrepreneurs:** Small-scale entrepreneurs play a key role in generating employment at grass route level—interior and rural part of the country. Thus, by helping small-scale entrepreneurs government can bridge the economic divide between rural India and urban India. The government should form special financial banks for granting loans and capital to small-scale entrepreneurs. Also, the government should appoint a special ministry or committee for development of small scale entrepreneurship in the country.
- **Identifying key sectors for developing entrepreneurship in the country:** The government should identify key sectors in the economy that hold tremendous growth for entrepreneurship. After identifying the key sectors, government should make special policies for these sectors. For example, the information technology industry became a phenomenal success in India only because the Indian government continuously made special policies and special laws for the IT sector.
- **Foreign direct investment:** Allowing foreign direct investment in key sectors will help the entrepreneurs in two ways: (i) access to foreign capital to drive the growth of their business and (ii) access to foreign technology.

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- **User-friendly policies:** The government should make user friendly policies and laws for driving the growth of entrepreneurship in the country. For example, lowering of taxes for sectors that have been affected by economic recession.
- **Conducting special programs:** The government should conduct special educational programs to drive the growth of entrepreneurship in the country. These educational programs should be specially targeted at the interior and rural parts of the country. These programs should aim at conveying the benefits of self employment.

Check Your Progress

1. How can the economic divide between rural India and urban India be bridged?
2. How does foreign direct investment in key sectors benefit entrepreneurs?

10.3 SMALL SCALE ENTREPRENEURS

Small scale entrepreneurs, as the name suggests refers to the entrepreneurs engaged in the small and medium enterprises. They have limited number of employees working for them and the flow of finance is also limited. Different countries have different definitions for small scale businesses. In India, the Ministry of Micro, Small and Medium Enterprises gives the following definition for such classification:

Table 10.1 What is MSME

Composite Criteria: Investment in Plant & Machinery/equipment and Annual Turnover			
Classification	Micro	Small	Medium
Manufacturing Enterprises and Enterprises rendering Services	Investment in Plant and Machinery or Equipment: Not more than ₹1 crore and Annual Turnover; not more than ₹5 crore	Investment in Plant and Machinery or Equipment: Not more than ₹10 crore and Annual Turnover ; not more than ₹50 crore	Investment in Plant and Machinery or Equipment: Not more than ₹50 crore and Annual Turnover; not more than ₹250 crore

Source: <https://msme.gov.in/know-about-msme>

In this section, we will discuss the role of small entrepreneurs in global and Indian scenario.

United States: In the United States, small business has benefited from direct cash injections. Procurement policy also seeks to increase the participation of small businesses, veteran-owned small businesses, small/disadvantaged business, and women-owned small businesses. The Small Business Act requires that each contract with an anticipated value of greater than US\$2,500 but less than US\$100,000 be reserved exclusively for small business concerns.

Latin America: After focusing on large investments and wooing multinationals for years, Latin American politicians are beginning to realize that SMEs are the true job creators as well as important players in technology supply chains.

Asia: Some of the world's best-performing economies, notably Taiwan and Hong Kong are very heavily based on small enterprises. The majority of enterprises were in the service sector, specifically import and export, and wholesale and retail trade. Korea, recognizing the importance of SMEs has introduced many measures that include tax breaks and reduced interest loans for those starting new businesses in rural areas.

China: China is rapidly emerging as a powerhouse, not only in the region, but worldwide. Part of this success has been owing to the strong performance of SME with the active support of the government. In China, urban and rural SMEs number is over 10 millions and accounts for 99 per cent of China's registered enterprise.

Role of Small Enterprises in Service Sector

A lot of economies, particularly those of developing countries like India, walk on the shoulders of small businesses, especially those involved in providing services. The numbers speak for themselves.

The Economic Survey 2019-20 has noted that 'Micro, Small & Medium Enterprises (MSMEs) contribute significantly in the economic and social development of the country by fostering entrepreneurship and generating largest employment opportunities at comparatively lower capital cost, next only to agriculture.'

- India's MSME Sector comprises of 633.88 lakh units as per National Sample Survey 73rd Round (2015-16).
- MSME sector has created about 11.10 crore jobs in the country as per National Sample Survey 73rd Round (2015-16).
- As per the information received from the Central Statistics Office (CSO), Ministry of Statistics & Programme Implementation (MOSPI), the Share of MSME Gross Value Added (GVA) in total GVA during 2016-17 was 31.8%.
- As per the information received from Directorate General of Commercial Intelligence and Statistics (DGCIS) the Share of MSME related Products in total Export from India during 2018-19 is 48.10%.

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India is ranked 63rd position among 190 countries in the World Bank's Doing Business 2020 Report. But the ranking for starting a business is a dismal 136.

As India emerges as one of the brightest economic spots in the new millennium, it should focus on ways to make help MSMEs, the most powerful driver of its growth survive, succeed and soar.

Service organizations vary widely in size. At one end of the spectrum are large companies such as airlines, telecoms, IT companies, banks and insurance companies. At the other end of the spectrum are an estimated 10-50 million Micro-Small-Medium-Enterprises (MSMEs) who offer myriad services in services ranging from astrologers to accountants, caterers to car cleaners, yoga instructors to musical bands, flooring contractors to roof leak repairers, interior decorators to movers and packers.

10.3.1 Importance and Problems of SSIs

Micro, small and medium enterprises are important in developing countries because:

- **Large Employment Opportunities:** These industries are labour-intensive and employ a large number of people.
- **Economical Use of Capital:** MSMEs are more suitable for a country like India as they need relatively small amounts of capital.
- **Balanced Regional Development:** They are also very helpful in balancing regional growth as most of these enterprises are based in rural areas.
- **Equitable Distribution of Income and Wealth:** Such enterprises remove various drawbacks of capitalism like concentration of wealth and economic power in the hands of few, abnormal profiteering, etc.
- **Higher Standard of Living:** These industries provide large-scale employment, and with employment comes income, which leads to an increase in the purchasing power of the individuals employed.
- **Mobilization of Local Resources:** As these industries are spread in the small towns and villages, it leads to the mobilization of resources in these areas.
- **Simple Technology:** MSMEs are very quick to adopt new but simple techniques of production.
- **Less Dependence on Foreign Capital:** These enterprises are dependent mainly on the savings of the entrepreneur and funding from financial institutions. Thus, the use of foreign funds is minimum.
- **Promotion of Self-employment:** Such enterprises promote self-employment among the educated and professional class.
- **Promotion of Exports:** There are a large number of MSMEs that are involved in export.
- **Protection of Environment:** There are many MSMEs that are manual and hence help in protecting the environment.

- **Facilitate Development of Large Scale Enterprises:** MSMEs support the development of large enterprises by meeting their requirements of inputs of raw materials, intermediate goods, spare parts, and so on, and by utilizing their output for further production.
- **Shorter Gestation Period:** In these enterprises, the time-lag between the execution of the investment project and the start of flow of consumable goods is relatively short.

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Advantage of MSMEs

The advantage of micro, small and medium enterprises are as follows:

- As these industries are labour intensive, they create more employment opportunities.
- These industries are based mainly on local resources.
- As many MSMEs are manual, they are comparatively safer for the environmental.
- The government provides support and patronage to these industries
- These industries provide ample opportunities for creativity and experimentation and innovation.
- By providing opportunity and generating employment, these industries help in balanced regional growth.
- As they require very less capital to set up, they are good for a country like India which is deficient in capital.

Disadvantage of MSMEs

The disadvantage of micro, small and medium enterprises are as follows:

- They always face tough competition from the large industries.
- These companies suffer from a lack of availability of experts as they cannot hire paid experts.
- These companies are not well armed to take benefits of the latest technology and modern methods.
- These companies have a very little scope for division of labour and specialization.

Check Your Progress

3. What does the Small Business Act state?
4. Which sector is the largest contributor to the Indian economy?
5. How can SSIs improve the standard of living of people?
6. State any two disadvantages of MSMEs.

10.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. By helping small-scale entrepreneurs, the government can bridge the economic divide between rural India and urban India.
2. Foreign direct investment in key sectors will help the entrepreneurs in two ways:
 - Access to foreign capital drives the growth of the business
 - It provides access to foreign technology.
3. The Small Business Act requires that each contract with an anticipated value of greater than US\$2,500 but less than US\$100,000 be reserved exclusively for small business concerns.
4. The services sector is the largest contributor to the Indian economy.
5. The SSIs provide large-scale employment, and with employment comes income, which leads to an increase in the purchasing power of the individuals employed.
6. The disadvantage of micro, small and medium enterprises are as follows:
 - They always face tough competition from the large industries.
 - These companies suffer from a lack of availability of experts as they cannot hire paid experts.

10.5 SUMMARY

- An entrepreneur is the catalyst for social change and works for the common good. Entrepreneurship is one of the most vital inputs in economic progress of a country. The number of entrepreneurs and their proficiency affect the economic growth.
- The crucial and significant role played by the entrepreneurs in the economic development of advanced countries has made the people of developing and under-developed countries realize the importance of entrepreneurship for economic development.
- Entrepreneurship helps in the process of economic development by generating employment, promoting capital formation, promoting regional development, improving living standards of people, improving the country's economic profile, and creating innovation.
- Entrepreneurs alone cannot drive the economic growth of the country. They will need the active support of the government through industry friendly policies and regulations. It is important to note that level of entrepreneurship

will stagnate in the country if the government continues to remain apathetic to the demands of entrepreneurs.

- A lot of economies, particularly those of developing countries like India, walk on the shoulders of small businesses, especially those involved in providing services. As India emerges as one of the brightest economic spots in the new millennium, it should focus on ways to make help MSMEs, the most powerful driver of its growth survive, succeed and soar.
- Small and medium enterprises are important in developing countries as it provides large employment opportunities, require small amount of capital, helps in regional development, promotes equitable distribution of income and wealth, improves standard of living, and mobilizes local resources.

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10.6 KEY WORDS

- **Capital formation:** It means increasing the stock of real capital in a country. In other words, it involves making of more capital goods such as equipments, tools, factories, etc. which are used for future production of goods.
- **Foreign direct investment:** It is an investment made by a firm or individual in one country into business interests located in another country.
- **GDP:** It stands for Gross Domestic Product. It is the total value of everything produced within a country's borders.

10.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. How can the government provide support to the entrepreneurs?
2. How can entrepreneurs promote capital formation?
3. Write a short note on the condition of small enterprises in the US, Latin America and Asia.
4. What are the advantages of MSMEs?

Long-Answer Questions

1. Discuss the importance of entrepreneurship in economic development of a country.
2. Explain the contribution of small enterprises to Indian economy.
3. Analyse the reasons why SSIs are considered important in developing countries.

10.8 FURTHER READINGS

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- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
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UNIT 11 CREATIVITY AND INNOVATION

*Creativity and
Innovation*

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Structure

- 11.0 Introduction
- 11.1 Objectives
- 11.2 Characteristics, Sources, and Importance of Innovation
 - 11.2.1 Forms of Innovations
 - 11.2.2 Innovation and Intreprenurship
 - 11.2.3 Innovation: Skills versus Ideas
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- 11.5 Answers to Check Your Progress Questions
- 11.6 Summary
- 11.7 Key Words
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11.0 INTRODUCTION

In this unit you will learn about innovation—its definition, classification, and its relation with entrepreneurship. Over the years, human societies have shifted from a natural world to a man-made world, a man-made world fashioned by innovation. Recent empirical studies show that more than half the increase in national output in developed countries stems from innovative technologies, establishing the importance of innovation as an engine for economic growth.

Innovation not only provides firms and entrepreneurs with rewards in terms of wealth and personal satisfaction, but also provides them an opportunity to make a contribution to society. Peter Drucker describes innovation as follows: ‘Innovation. . . is the means by which the entrepreneur either creates new wealth-producing resources or endows existing resources with enhanced potential for creating wealth.’

One would imagine that innovation, as a major source of wealth creation, would be a very important activity of business firms. Business firms are best equipped to provide a lead in innovation as they generally have the resources and infrastructure to promote ideas, incubate them, and market them. They are also better equipped to recognize new ideas, see opportunities in them, and develop these into products or services. Innovation is the way in which a firm can establish a competitive advantage over their rivals.

Yet, the corporate world has not shown itself to be very conducive to promote creativity and innovation. The significant number of critical innovations that have

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come outside organized industry is surprising. Some historical information on innovations is mentioned as follows:

- (i) 40—60 per cent of all patents in the period 1950–90 were filed by persons who worked outside organized research teams of industrial laboratories.
- (ii) Forty of the sixty-one important inventions made since 1900 were the product of independent innovators, working alone, unaffiliated with any industrial laboratory.
- (iii) Individuals working without support played a major role in most important inventions for military use such as the following:

• Jet engine	Sir Frank Whittle
• Gyrocompass	H. Anschutz-Kaempfe
• Helicopter	Igor I. Sikorsky
• Rockets	Obert H. Goddard
• Suspension tanks	George Christie
• Atomic submarine	Admiral H. Rickover
• Sidewinder missile	William B. Mclean
• Stainless steel	Elwood Haynes
• Titanium	W.J. Kroll

These facts seem to show that a large percentage of innovations have an entrepreneurial flavour of individuals and not of organized industry. The major reason that many organizations have not been able to innovate is due to the nature of business firms. The inherent preferences of organizations are clarity, certainty and perfection, whilst the inherent nature of creativity involves ambiguity, uncertainty and imperfection. However, it does not have to be that way. How one honours, balances and integrates the needs of both is the real challenge.

No one can doubt that business firms have critical resources, in greater abundance, than individuals do. They are better equipped to support and encourage innovation. The challenge for managers, therefore, is to change their ways of thinking and behaviour, so that the potential to innovate within their respective organizations is realized. If not, innovation will gradually become the monopoly of individual entrepreneurs, and business organizations will find themselves easy victims of ‘creative destruction’.

Thus, it is clear that both firms and entrepreneurs become wealthier when they innovate or promote innovation. There is a basic requirement for organizations to develop innovative capability.

In this unit, we will discuss innovation and entrepreneurship keeping this dichotomy in mind. We will start by explaining what innovation is and the theory of innovation, the Popper model. We will then discuss the various classification

systems of innovations and how innovation is related to entrepreneurship. Finally, we will discuss the importance of creativity and some of the important innovations that left a global impact.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the characteristics, sources, importance and forms of innovation
- Explain the importance of creativity
- Examine some of the important innovations that left a global impact

11.2 CHARACTERISTICS, SOURCES AND IMPORTANCE OF INNOVATION

Creativity and innovativeness are highly related concepts and they result in the development of innovations. However, the terms ‘creativity’ and ‘innovation’ are often used interchangeably. This denies the fact that each has a unique connotation. Creativity relates to the ability to bring something new into existence, while innovation is the process of doing new things. This distinction is important. Therefore, creativity is a prerequisite to innovation.

In creativity, we emphasize the ‘ability’, not the ‘activity’. When a person conceives of something new and envisions how it will be useful, but does not take the necessary action to make it a reality, the idea has little value. However, innovation is often more difficult. Transformation from ideas into a successful product is difficult. This transformation is the heart of the complex process of ‘innovation’.

Not every invention is transformed into an innovation, and consequently, not every innovation can be successful. Few inventions are successfully innovated into new products, and even fewer new products succeed commercially. However, the pay-off for successful innovation is extremely large and can put a firm or an entrepreneur as an undisputed market leader for decades.

Entrepreneurship focuses on converting ideas into new products, services, or processes. Therefore, innovation is a critical part of entrepreneurship as it creates the forces of ‘creative destruction’ of Schumpeter by bringing in new businesses and products which have a unique role in transforming society.

The impact of ‘innovation’ may range from strengthening existing competencies of the firm to making obsolete existing competencies, for instance, product design, process, skills of personnel, knowledge base. It may change relationships to customer bases, channels of distribution, customer applications, and customer knowledge, etc., either reinforcing existing patterns or radically altering them.

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The discussion shows that ‘innovation’ is a difficult term to define. This is because the variety in the range of artifacts covered under the umbrella of innovation, make it a difficult quantity to measure. Many people associate ‘innovation’ with dramatically improved products and services. Yet this type of innovation is only one possible result of ‘innovativeness’. Innovation can be a machine to replace hand cutting of metal. It can be a simple sociological technique as reorganization of work force for more effective production. It can be a mathematical formula, such as an algorithm.

Therefore, innovation is the transfer of ideas into artefacts. Innovation is the creation of new artifacts. One artifact gives rise to many others. They combine into hardware modules and systems. These are developed and then applied, through soft artifacts—procedures, methods, techniques and skills. Finally, both development and use of these artifacts become subject to governing systems, like rules, laws and implementing institutions, that in themselves are soft artifacts.

Sir Karl Raimond Popper, the Austrian born British philosopher, explains innovation through the Popper Model. Popper approaches innovation as a methodological evolution. Innovation is treated as a scientific method.

Innovation begins with a problem (P_1) and ends with a new problem (P_2), which is the intermediate solution. P_1 may be a practical problem or an inconsistency between current theory and observation. This is solved by conjecture by postulating a new tentative theory (TT).

According to Popper, a theory is never confirmed or proved. It remains acceptable as long as it is not refuted. Therefore, to confirm the tentative theory, a set of experiments is devised to disprove or refute it by an error elimination process (EE). Thus, by a process of conjecture and refutation one accepts a theory. The creative process of innovation is graphically shown in Figure 11.1.

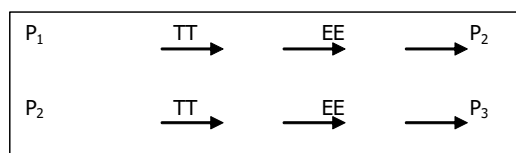


Fig. 11.1 *The Popper Model*

Once a theory is accepted, it represents a new problem. The creative process begins anew as this problem also requires a solution, thereby creating a new cycle of innovation. It begins with the problem (P_2) and ends with a new problem (P_3). Each solution, therefore, generates a new challenge that in turn results in evolving new solutions.

His theory suggests that when there are multiple solutions to a specific problem, then one innovation will create more than one innovation. In other words, innovations generally grow in a manner that is exponential as each innovation brings

in a number of new innovations, which in turn bring in more innovations. We are experiencing this phenomenon as the winds of change are sweeping away old ways of life and replacing them with new ways. Not only are these changes now becoming more rapid, but also more extensive, more profound and pitiless than ever before.

Developments in information technology, cellular radio, biotechnology, and global finance, to name a few, are changing the way we live our lives. Every day, we are witnessing the growth of new industries, new products and services, compared to the day before. Innovations are invading business operations from all directions and in almost all areas.

Armed with ever more sophisticated research technologies, more creative work environments, and a continuing drive to harness nature everywhere, changes have become and are bound to be more rampant in the future. Many organizations are not able to keep up with the changes that we see today, as the nature of change is becoming more unpredictable. This is true even for those who are bracketed with the best. These challenges will become bigger and more frequent in the near future.

This environment of change is both a blessing and a threat. It is important to recognize this because sometimes the challenge of change is of survival itself. Entrepreneurs, whether they are individuals or companies, have to learn to work faster, more efficiently and produce new products more regularly to survive. Creativity and innovation will play a very important role in the future, to meet these challenges of change.

Sources of Innovation

There can be many sources of innovation. The following are some of the common sources of innovation as per Peter F Drucker:

- Process needs
- Changes in the market and industry
- Perception related changes
- Needs arising out of incongruities in the present technologies
- Presence of new knowledge
- Unexpected occurrences
- Changes in the demography

Importance of Innovation

The following points highlight the benefits which makes innovation important to businesses:

- It helps in maintaining the relevancy of the company in the dynamic marketing environment.
- It assists companies to grow and expand.

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- It also helps company create their own unique selling position by differentiating themselves from the other companies.
- It assists companies in meeting increasing complex and detailed consumer expectations.
- It allows companies to incorporate technological betterments.

11.2.1 Forms of Innovations

Are all innovations similar or is there a difference between different innovations? This question needs an answer in order to understand the nature of innovations and the different types of entrepreneurship necessary for different categories of innovations.

Using a scientific framework, we can distinguish between innovations. This is an important exercise as we will be able to systemize the nature of innovations. A question that usually arises is whether innovations are mind-boggling exercises or are they simple sets of novel ideas and thoughts. This separation of the nature of innovations is achieved in the classification models that follow. The two most accepted classification systems of innovations are the Marquis's Classification and the classification system of Henderson and Clark.

(a) Marquis's classification

According to Marquis's classification, innovations differ significantly in the degree of technological change and its relationships with other parts of technology. Based on this, there are three general types of innovation, which are:

(i) Radical innovations

Radical innovations can lead either to a new product class life cycle or a technological discontinuity in an existing life cycle. For instance, the invention of the automobile would probably be viewed as a new life cycle. It cannot be considered a continuation of the 'personal transportation vehicle life cycle', as represented by horse carriages or bicycles in those days.

In 1935, Chester Carlson was working in the Patent Office of Mallory Company. Using his technical background, he began experimenting with new ways to create a copying process. His basic idea was to project the image of the typed paper on a blank sheet of paper coated with dry ink, to hold the ink at the typed spaces using static electricity and finally melting the ink by baking the paper. Carlson succeeded in obtaining a crude image, thereby converting his idea to practice. By 1942, he had obtained the patent for the process.

Like most new ideas, it was not commercially efficient, cost effective or usable. It required development. Development costs money, takes time, and requires skilled resources. Carlson went from company to company seeking support. He was turned down, again and again. Battelle Memorial Institute, which had a range of advanced technical research capabilities,

agreed to work on the development in return for a share of the potential royalties.

In 1945, a small company named Halloid learnt of Carlson's patents. Joseph Wilson, the president, was looking for new products. Halloid produced the first copiers, using Carlson's patent and Battelle's developments. The company became Xerox, creating a new industry in office copying products. Xerox grew, keeping a technological and marketing dominance over the industry for over three decades.

Xerography, invented by Carlson, was a radical innovation. Other examples were the electronic vacuum tube and the transistor, which revolutionized the electronics industry. Yet other examples are the incandescent lamp invented by Edison and microprocessors by Intel and Advanced Memory Systems, each of which fostered new industries. The automobile was a radical innovation. It created a new product class. It was not a continuation of the then existing 'personal transportation' market, which included bicycles, buggies, etc.

(ii) System innovations

System innovations create a new functionality by assembling parts in new ways. This is also called, 'evolutionary innovation'. For instance, the vacuum tube was first used in long distance telephony. It was improved and modified to become a part of radio communications, television communication systems, and computer systems. The transistors first substituted for vacuum tubes and then went on to develop into a major input for applications in digital technologies and electronics. The development of Ford's Model T was followed by the innovation of the assembly line.

Gottlieb Daimler manufactured the first gasoline powered automobile in 1887. From 1887 to 1902 many firms emerged and marketed a variety of motorcars for the market. The model T was introduced in 1908. Model T was a systems innovation. It contained innovations and inventions that were incorporated in many cars before it. A new feature of the Model T was its independent chassis and body design.

The story is, in 1905, Henry Ford saw a French automobile crash in a road race. After the race, he walked over to the wreck examining it. He picked up one of the valve stems from the engine and noticed its lightness. Ford took this back to his factory and examined it. It was vanadium steel and had twice the strength of American steel. Ford was excited. This gave rise to totally new design possibilities. Ford approached a number of leading steel manufacturers, but could not find this quality of steel. Finally, he made a deal with a small steel company in Canton, Ohio, to research and manufacture this grade of steel.

In those days, all roads in America were dirt roads, with potholes and ruts. The early cars bounced and bumped on these roads and the chassis would

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crack. Motors were bolted directly to the chassis, and sometimes they were literally twisted in half due to a pothole twisting the chassis. Ford started on the Model T design; its chassis was to be built of vanadium steel, the engine was to be suspended on rubber mounts. He also added many other refinements, which were already in use in other cars manufactured during that period.

Model T emerged as the first car with all the features which became regular features of most cars manufactured as late as 1970, for instance, longitudinally mounted engine connected to the rear wheel drive via a torque tube, 'H' transmission, water cooled engine independent chassis and body design, etc.

Innovation in tyre technology means creating the radial tyre that can be considered as an evolution in tyre technology or a 'system' innovation. Similarly, mainframe computers have gone through a series of evolutionary changes, from vacuum tubes to the transistor, from the transistor to integrated circuits. Now, integrated circuits are widely used.

The example of the Ford Motor Company exemplifies the evolutionary nature of innovation. Though the motorcar was a radical innovation, Ford's Model 'T' was an evolution of the motorcar designs already available to the consumer; it was a system innovation.

(b) Henderson and Clark's classification

Many products and processes are composed of a number of distinct sub-technologies. If a radical innovation takes place in one of these sub-technologies and does not take place in others, the classification of the product either as a 'radical' or 'system' innovation becomes problematic.

In this context, Henderson and Clark distinguish between a product as a whole and the sub-technologies that go into the making of the product or service. It is easier to explain the Henderson and Clark classification using an industry example. If we look at the automobile, it consists of several sub-technologies combined together into a larger system. According to this classification, innovations can be classified in the manner in which these are combined. Therefore innovations can occur in both of the following:

- (i) The core concepts associated with individual sub-technologies.
- (ii) The architecture or the way the sub-technologies are combined into a larger system.

The innovation spectrum of possibilities, if defined using these two dimensions, can create four types of innovations. These have been identified as incremental, architectural, modular and radical innovations by Henderson and Clark. A short description of each type in this classification is as follows:

- (i) **Incremental innovations:** Where core sub-technologies are reinforced, but linkages among these remain unchanged. For instance, successive

generations of software, such as WordPerfect or Microsoft Word are incremental innovations, as established designs and sub-technologies are used.

- (ii) **Architectural innovations:** Where core sub-technologies are reinforced and linkages among sub-technologies are changed. Examples include products like personal computers where existing sub-technologies were linked in a new way.
- (iii) **Modular innovations:** Where sub-technologies are overturned, but linkages among sub-technologies remain unchanged. For instance, in products like digital telephones there were changes in the core sub-technologies, but no changes in the product's overall architecture.
- (iv) **Radical innovations:** Where core sub-technologies are overturned and linkages among sub-technologies are also changed. Examples include products like transistors, instant photography (Polaroid), etc.

11.2.2 Innovation and Entrepreneurship

Innovation and invention are two terms that are often used incorrectly. Before we proceed further, we need to differentiate clearly between 'innovation', and 'invention'. The distinction between 'invention' and 'innovation' is an important one.

According to Wikipedia, 'An inventor is a person who creates or discovers a new method, form, device or other useful means.' Inventors, therefore, are not limited to those who create new products, but they include those who identify new technological processes, new forms of plant life, and new designs. Invention is the creation of a new configuration, device, or process. Most inventions deal with new processes or new technical knowledge of pre-existing models or ideas.

An invention is the practical and material embodiment of a concept or idea. It produces an artifactual form that is judged to be significantly original by at least the inventor designer, but more acceptably by the relevant community.

When people have passed through the illumination and verification stages of creativity they may have become inventors, but they are not yet innovators. For an invention to become an innovation, the opportunity has to be exploited. Innovation is the process of doing new things in which a product or service is produced that is judged to be significantly original by the relevant community.

Table 11.1 gives a list of important innovations. In some of these products, the inventor(s) and innovator(s) were not the same; in some cases the inventors joined up with innovators; and in other cases the innovator and the inventor were the same.

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Table 11.1 Products, Inventor(s) and Innovator(s)

Product	Inventor(s)	Innovator(s)
Steam Engine	John Fitch	Robert Fulton, Oliver Evans
Telegraph	Joseph Henry	Samuel Morse
Radio	Guglielino Marconi	Edwin Armstrong
Revolving Pistol	Samuel Colt	Samuel Colt, H. Smith & D. Wesson
Sewing Machine	Elias Howe	Isaac Singer
Automobile	Nicolas Cugnot	Henry Ford
Airplane	Wright Brothers	Wright Brothers, Juan Trippe
PC Software	Gary Kildall	Steve Jobs, Bill Gates
Personal Photography	George Eastman	George Eastman, Edwin land

Table 11.1 shows the product, the inventor and the innovator. It should make it absolutely clear that commercial exploitation of an invention is an innovation. ‘Innovation’ starts where ‘invention’ stops. This statement emphasizes the fact that innovation implies action, and when the new ideas conceived are transformed into new products, services or processes, it results in an innovation. Therefore, innovation is the conversion of creative ideas into useful applications.

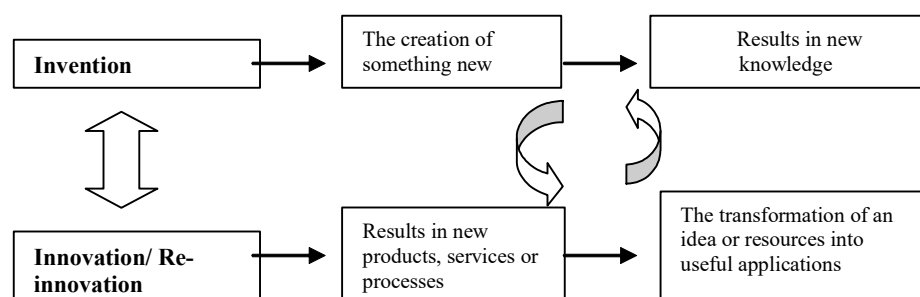
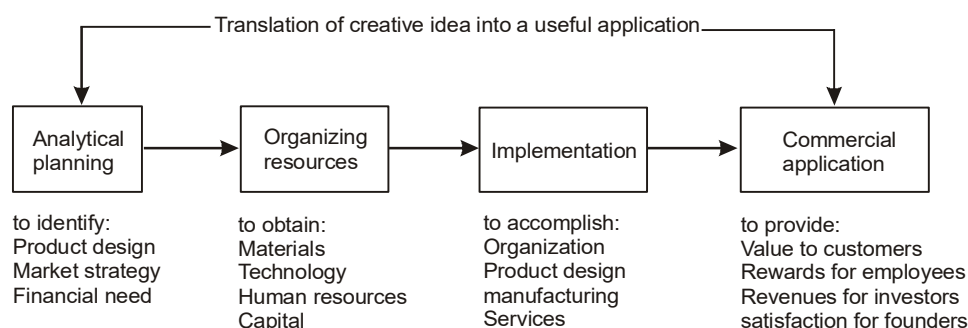


Fig. 11.2 Invention versus Innovation

An artifact develops through invention, innovation and re-innovation. Invention and innovation and re-innovation form a continuous never-ending cycle. The cycle of invention, innovation, and re-innovation is shown in Figure 11.2. Commercial exploitation of an original idea is an innovation. Improvements to the idea are re-innovations.

An innovation starts with an idea which must have value. In order to have value, it must either be proven useful or be marketable. For either of these requirements to be fulfilled, the idea must be developed. Innovation is the development process; it is the translation of an idea into an application.

This translation of an idea into a useful application is shown in Figure 11.3. This process is important because each innovation has the potential to lead to new ideas. These ideas when turned into innovations help firms to maintain or improve their position in the marketplace. There are a numerous stories that show how many firms were able to do this through innovation and how important innovation is in the creation of wealth.

**NOTES****Fig. 11.3** *From Innovation to Application*

If you are an inventor who wants to turn the invention into an innovation, your choices include: (i) attempt to play the roles of both inventor and innovator entrepreneur, (ii) partner with an entrepreneur who has innovative skills, or (iii) sell the invention to an entrepreneur early enough to net you nominal value.

The first option requires you to have persistence in analytically working out the details of product design or service, to develop a marketing strategy; estimate the financial requirements and obtain finances for materials and technical manufacturing capabilities, and manpower requirements for operations; establish an organization, implement the product design, and plan operations; and finally provide value to customers, and benefits to employees, investors and the entrepreneur.

The other options for the inventor are to find a partner and have the product manufactured by someone else, perhaps another entrepreneur who finds the product and the process attractive enough with the potential for creating wealth. The last alternative is to sell the invention to an entrepreneur who will develop the idea into a product, process, or service.

The accelerating rates of growth of knowledge and technological discontinuities have important implications. The unrelenting pace of change is creating challenges, ranging from direct threats like increased competition or technical substitution, and also new opportunities opened up by contemporary technologies or the development of new markets.

11.2.3 Innovation: Skills versus Ideas

In spite of classical economic theories, innovation dictates economic activities, which are promoted by entrepreneurial activities, and entrepreneurial activities depend, to a large extent, on innovations. Many new products (and entire industries) are founded on innovative ideas that have applications which often change the face of an entire industry: how it works, and for whom it works, and what it works for. The example of Henry Ford's assembly line, discussed earlier in the unit, illustrates the point.

However, not all inventions can become innovations. When does an invention become worth exploiting as an innovation? We need some type of measure to

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determine this. Conventional wisdom says that the measure of an innovation should be in terms of the added value provided to the consumer or the potential it has for creating wealth for the entrepreneur. Therefore, an innovation should have either of the following factors:

- Provide the same product or service at a lower cost.
- Provide a better product or service at the same cost.
- Provide a new product or service that was not available earlier that provides value to the consumer.

Innovation, therefore, is a viable proposition when the idea provides new information or knowledge, which can be used effectively in industrial operations. The end result should be a measurable effect on costs, quality, level of output or sales, and other ancillary operations of the firm. If this happens, the innovation will ultimately provide benefits to both the entrepreneur and society.

Innovation is successful if we have the ability to encourage creative ideas which have these characteristics. However, to reach that stage, we first need to encourage creativity. Creativity is the basis for bringing in new ideas and knowledge and is seed that provides the new information, knowledge, and ideas.

The battle between rational, left-brain behaviour, and creative, right-brain behaviour, is the most common problem for innovating products and processes. Though the creative idea is extremely important, rational, analytical behaviour has a very important place for tangible products or processes. An innovator has to use left-brain rationality to 'harvest' right-brain creativity. The success to innovation and entrepreneurship is based on the ability of the inventor in resolving this dichotomous behaviour.

Keeping in mind the difficulty of dominant orientation, models have been developed to overcome this problem. A popular model, derived from a number of corporate studies in research and development, provides the structure for entrepreneurial activities and the conditions under which this structure is successful.

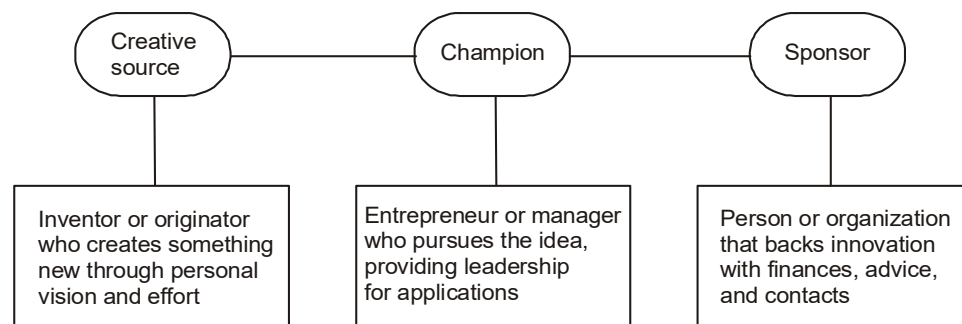


Fig. 11.4 *Innovation Model*

Figure 11.4 schematically describes the structural requirements of the model. In the structure, the model recognizes three important people/roles; the creative source, the champion, and the sponsor, who need to be involved together

in order to ensure the success of an innovation. The three key roles are explained as follows:

- (i) **Creative source:** The creative source is always an individual as organizations do not create ideas. He or she is the inventor and the originator of the idea. It is the idea that leads to the knowledge or vision of something new. In other words, the creative source is the artist of creative endeavor.
- (ii) **Champion:** The champion is the entrepreneurial mind. The champion may also be an individual; it may be the inventor himself, i.e., the creative source, an entrepreneur who joins with the inventor, or a corporate manager who has the insight to help in the pursuit of a creative idea. The function of the champion is in planning the application of the idea, through acquiring resources and establishing markets for the artifact through persistence, planning, organizing, and leadership.
- (iii) **Sponsor:** The sponsor may be an investor (such as, a venture capitalist), or an organization that provides corporate resources for the innovative project and their champions. The sponsor makes it possible to actualize the inventor's dreams and the champion's activities through support, including finances, contacts, and advice.

This structure is reflected in the models adopted by venture capital firms. Now, individual inventors also have this option available to them. Venture capital firms take up the mandate of champions and sponsors after determining the value of an idea. If they find it interesting, they sponsor and champion it. Venture capitalists are trained to recognize change and examine inventions to envision their opportunities. They provide mentoring and provide resources to create new ventures; and the inventor, who has harvested right-brain inspiration through left-brain hard work, provides the idea. Together, they try to create wealth.

However, having this structure is not a sufficient requirement for success in business organizations. There are seven important conditions, in addition, that need to be fulfilled. These create conditions which make it easier for the model to combine both qualities (rationality and creativity) through the structural framework. Both these are critical to successful innovations. These conditions are enumerated as follows:

- (i) Executive leadership should be provided by an outstanding person who is in a position to support strategic decisions that encourage creativity and innovation development.
- (ii) The operational leader has to be competent to carry out the essential tasks of converting knowledge into a commercial application.
- (iii) The sponsor should establish a clear need for the application by sufficient potential consumers as most innovators are highly optimistic about their ideas. The potential should be more than the minimum required to warrant commitment of resources to the innovation.

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- (iv) There should be a conviction that the product, process, or service will be a useful innovation and will provide value to society.
- (v) An important requirement for successful innovations is a high level of cooperation among the crucial players and among diversified functions in an organization. All of those who are involved, must together, bring the idea to fruition.
- (vi) The resources required should be budgeted and be available in a timely manner. It should provide the support required for the team to succeed in the endeavour.
- (vii) External sources who can influence the success of an innovation, including government agencies, investors, vendors, suppliers, and creditors should be identified and their cooperation and support should be ensured.

These conditions apply equally to existing projects within an organization and new entrepreneurial ventures. The seven conditions required for success in innovation are related partially to the success of the three key people involved and partially to the environment in which innovation takes place. It is the combination of the structure and conditions that is necessary in implementing the creative idea successfully.

These seven conditions and the three major players are illustrated in many new developments taking place. Several firms and industries have realized that innovations are a blessing for they provide new opportunities, new markets and new ways of doing things. They also realize that they are a threat because they keep transforming the business environment. Therefore, for these firms, innovation becomes critical both for survival as well as a means of creating wealth. An example of such a firm is 3M.

3M started as a mining company, a business in which it failed, and eventually stumbled onto most of the successful innovations that we know. It is best known for its innovations. Its innovative products, such as Post-it Note, Scotchgard, Masking and Scotch tape, are now household brands.

3M works on the '15 per cent rule'—technical people spend up to 15 per cent of their time on projects of their own choosing or initiative. 3M also introduced a '25 per cent rule', i.e., each division should produce 25 per cent of annual sales from new products and services introduced in the previous five years. This has now been increased to 30 per cent. These steps encourage inventors as well as champions. Using these rules, 3M has institutionalized 'inventors' and 'champions' to drive innovation.

In addition, other growth mechanisms that they created to stimulate internal entrepreneurship, was to develop tests for new ideas; share new ideas to develop new innovation; cross-fertilize technology, ideas and innovation; stimulate innovation via customer problems; speed product development and market introduction cycles; and provide profit sharing. These steps ensure that 3M is seen as a sponsor for innovative ideas.

They have also promoted the concept of ‘a small company within a big company feel’. They have also instituted ‘Golden Step’ awards which are given to those creating successful new business ventures originated within 3M. To make these policies succeed, they have created small autonomous business units and product divisions.

Many firms have now taken up the challenges posed by innovations. They encourage employees to take up the creative challenge of new ideas daily with support systems in place. These include an entrepreneurial champion who helps them in developing a creative idea into a marketable application; and they sponsor the innovation.

This phenomenon of developing a model that helps convert ideas to innovation has worked both at the firm level as well as at the individual’s level. It has also created the basis for a new industry—Venture Capital—that plays a critical role in innovation.

These developments, especially the change in mindset of the role of innovations and creation of adequate infrastructure for innovations, partially explain the high pace of change. They also explain why many of those innovations we take for granted today have developed in the last two decades. Some such examples are as follows: in products we have mobile phones; in process technologies we have synthetic fabrics; and in services we have Internet banking services, and ATMs, etc.

Check Your Progress

1. What are the two prominent classification systems of innovations?
2. What are system innovations also known as?
3. What are modular innovations?

11.3 CREATIVITY AND ITS IMPORTANCE

That man is simply a creative species is true. It can be seen in thousands of ways everyday. Each one of us is capable to initiate an idea and transform it into usable hardware. There are thousands of mundane objects at home or at office that you take for granted. Ordinary men, whose names you do not know, have designed them. These artefacts illustrate the innate quality of creativity in man.

Creativity is an indispensable element in entrepreneurship. Creative and imaginative people germinate ideas and nurture them; and entrepreneurs develop them successfully. Entrepreneurs do not need to be creative themselves, but their involvement in the creative process is essential to translate ideas into realistic and useful applications. It is necessary for entrepreneurs to get hold of ideas that they can pursue, as ideas seldom materialize accidentally.

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Explaining creativity

Ideas usually evolve through a creative process. A challenge facing the cognitive sciences is explaining 'creativity' satisfactorily. What are these elements, and how do these elements combine, is deeply debated. A number of theories have been put forward to explain the process. Some of these theories are extremely interesting, but still do not tell us what 'creativity' is.

Creativity involves the ability to take existing objects and combine them for new purposes in various ways. Creativity also involves the translation of our unique talents, gifts, and vision into an external reality that is new and useful. For example, Gutenberg took the winepress and the die/punch and produced a printing press.

Most researchers agree upon 'creativity' having aspects such as originality, appropriateness, which is reflected in the production of works of value to society. We must keep in mind that creativity takes place inside our own personal, social, and cultural boundaries. For our purposes, we will describe creativity as, 'the action of combining elements never combined previously to generate novel and useful ideas to problems and everyday challenges.'

Convergent and divergent thinking

What makes a creative person? In order to answer the question you need to look more deeply into the basis for innovativeness and creativity.

What distinguishes creative behaviour from other forms of behaviour is that it rests on the thinking abilities of the person concerned. Studies of known living creative people and research, gleaned from biographies of recognized past creative geniuses, have yielded some ideas about the characteristics of the creative process. The single most important element in the creative process, however, is originality or uniqueness. This originality or uniqueness comes from the problem solving abilities of the concerned individual.

Measures have been designed to assess the interrelationship between creativity and intelligence. Surprisingly, there seems to be very little. In a group of school children who were administered a creativity test and an intelligence test, it was found there was only about a 30 per cent overlap. This means that by just measuring intelligence, you miss 70 per cent of the creative students.

One can distinguish between two basic types of thinking or problem solving abilities, convergent and divergent reasoning. They are as follows:

- Convergent thinking is the intellectual ability to logically evaluate, critique and choose the best idea from a selection of ideas.
- Divergent thinking is the intellectual ability to think of many original, diverse and elaborate ideas.

If one were to ask the question, 'Which city near Delhi has one of the wonders of the world?' the answer would be, 'Agra'. If one were to ask, 'What is the square root of 25?' The answer would be '5'.

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In these questions, the problems are such that there is only one answer. Anyone knowing the basic logical, mathematical or memory operations can reach the right answer. This is a typical problem-solving situation involving convergent thinking. The characteristic of convergent thinking is that it is intellectual, digital, secondary, abstract, directed, propositional, analytic, lineal, rational, sequential, and objective.

There is another set of problem solving questions that do not yield one correct solution. For example, 'What would have happened if the steam engine had not been invented?' 'How many uses are there of a brick?' or 'Why is it that books are generally rectangular and not square, circular or triangular in shape?' To solve these problems the mind would have to go into uncharted areas. In these questions, there can be as many answers as your imagination will permit. The person would have to adopt new frames of reference, draw on his imagination and intuition, and seek novel relationships. This is a case of divergent thinking.

Divergent thinking is generally believed to be the basis for 'creativity' and is identified, not with a single ability, but with a cluster of abilities. Some of the more important abilities are as follows:

- Fluency, or the ability to come up with large number of ideas or solutions or concepts or words in response to a given stimulus
- Flexibility, or the ability to come up with a *variety* of ideas or solutions or concepts
- Originality, the ability to come up with useful ideas or solutions that others have not thought of
- Sensitivity to the unusual, to be able to recognize anomalies or problems
- Ability to identify the causes of a situation or a problem
- The ability to elaborate and redefine a problem

The characteristic of divergent thinking is that it is analogic, primary, concrete, free, imaginative, relational, nonlinear, intuitive, and holistic.

In general, you can distinguish between the two basic types of problem-solving abilities as follows:

- (i) Convergent thinking: the analytic reasoning measured by intelligence tests, and
- (ii) Divergent thinking: a richness of ideas and originality of thinking.

While divergent thinking is undoubtedly the distinguishing characteristic of creativity, there is a place for convergent thinking too. Indeed, creativity generally consists of phases of divergent (imaginative) and convergent (rational) thinking. Both seem necessary to creative performance. Divergent thinking is essential to the novelty of creative products whereas convergent thinking is fundamental to the appropriateness. Both abilities are required for creative output.

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It must be recognized that innovation, which is the ultimate objective of creativity in the entrepreneurial process, consists of two distinct stages. The first stage is the design of an innovation, and the second stage is the implementation of the idea. During the first stage, divergent thinking is predominant, but in the second stage convergent thinking ability has to be dominant.

According to Guilford, 'Divergent thinking ... comes into play whenever there is trial and error thinking.' Further, in divergent thinking operations you think in different directions, searching or seeking variety. In convergent thinking, the information leads to one right answer or to a recognized best or conventional answer.

Indeed, creativity generally consists of phases of divergent (imaginative) and convergent (rational) thinking. Although, according to the task or occupation divergent and convergent thinking are found in different degrees—a mathematician may exhibit more convergent than divergent thinking and an artist the reverse.

It seems logical to deduce that in order for a person to be highly creative, he has to be high on convergent thinking as well as divergent thinking.

Check Your Progress

4. What is the characteristic of divergent thinking?
5. What is divergent thinking?

11.4 GLOBAL AND INDIAN INNOVATIONS

Given below are some of the important global and Indian innovations:

- **The Integrated Circuit:** The first integrated circuits were created by Jack Kilby of Texas Instruments and Robert Noyce of Fairchild Semiconductor in 1959. The integrated circuits, which later developed into microprocessors, ended up being used in almost all computers
- **The Internet:** In 1969, the United States Department of Defense Advanced Research Projects Agency (then called ARPA, today called DARPA) created the Internet, then known as the ARPANET, with an aim to connect researchers. The World Wide Web was used as a communication tool that maintained a constantly updated record of human knowledge and expression.
- **Microprocessors:** Ted Hoff of Intel created the microprocessor in 1971. The microprocessor was an integrated circuit; it had all the functions of the computer or a central processing unit (CPU) on it.
- **USB:** Indian-American Ajay Bhatt developed that USB technology. Also known as Intel Universal Serial Bus, this technology is now used in approximately 10 billion devices globally.

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- **Cipla Generic HIV Drug:** Pharmaceutical Company Cipla developed a revolutionary anti-HIV drug that became a turning point in the history of AIDS therapy. This revolutionary drug introduced on 6 February 2001 was made up of three drugs, namely, Nevirapine, Didanosine and Zidovudine. Moreover, it was offered to poor African countries and aid groups for \$350 a year, prompting other companies to bring down their prices. At less than a dollar a day, that was one thirtieth of the standard price.
- **The Smartphone:** The iPhone was launched on 9 January, 2007. It quickly became the most widely available smartphone with multi-touch capabilities. The multi-touch smartphone paved the way for other developments such as the tablet and the convergence of the laptop, tablet and smartphone as well as new hybrids such as cloud-connected glasses and smart watches.
- **The Quantum Computer:** In 2011, the first quantum computer was brought to market by D-wave. Quantum computers use superposition and entanglement to solve some computing problems thousands of times faster than traditional computers.

More recently in the past decade (2011-2020), there have been many different types of innovations which have either changed the industry or brought about new avenues of businesses. Some of the notable recent inventions include virtual assistants by Google, Amazon and Apple; reusable rockets by SpaceX, self-driven cars by Google and Apple; Consumer LED bulbs; battery operated cars, facial recognition technologies, online streaming services, smartphone enabled cab hailing aggregators, smart speakers among many more.

Check Your Progress

6. Who created the integrated circuit?
7. When was iPhone first launched?
8. In which year was the first quantum computer introduced?

11.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The two most accepted classification systems of innovations are the Marquis's Classification and the classification system of Henderson and Clark.
2. System innovations are also known as 'evolutionary innovations'.
3. Modular innovations are innovations where sub-technologies are overturned, but linkages among sub-technologies remain unchanged. For instance, in products like digital telephones there were changes in the core sub-technologies, but no changes in the product's overall architecture.

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4. The characteristic of convergent thinking is that it is intellectual, digital, secondary, abstract, directed, propositional, analytic, lineal, rational, sequential, and objective.
5. Divergent thinking is the intellectual ability to think of many original, diverse and elaborate ideas.
6. The first integrated circuits were created by Jack Kilby of Texas Instruments and Robert Noyce of Fairchild Semiconductor in 1959.
7. The iPhone was launched on 9 January, 2007.
8. In 2011, the first quantum computer was brought to market by D-wave.

11.6 SUMMARY

- Creativity relates to the ability to bring something new into existence, while innovation is the process of doing new things. This distinction is important. Therefore, creativity is a prerequisite to innovation.
- Entrepreneurship focuses on converting ideas into new products, services, or processes. Therefore, innovation is a critical part of entrepreneurship as it creates the forces of ‘creative destruction’ of Schumpeter by bringing in new businesses and products which have a unique role in transforming society.
- Sir Karl Raimond Popper, the Austrian born British philosopher, explains innovation through the Popper Model. Popper approaches innovation as a methodological evolution. Innovation is treated as a scientific method.
- Popper’s theory suggests that when there are multiple solutions to a specific problem, then one innovation will create more than one innovation. In other words, innovations generally grow in a manner that is exponential as each innovation brings in a number of new innovations, which in turn bring in more innovations.
- The two most accepted classification systems of innovations are the Marquis’s Classification and the classification system of Henderson and Clark.
- According to Marquis’s classification, innovations differ significantly in the degree of technological change and its relationships with other parts of technology. Based on this, innovations can be classified into radical innovations and system innovations.
- Many products and processes are composed of a number of distinct subtechnologies. If a radical innovation takes place in one of these sub-technologies and does not take place in others, the classification of the product either as a ‘radical’ or ‘system’ innovation becomes problematic.
- Henderson and Clark distinguish between a product as a whole and the sub-technologies that go into the making of the product or service. According

to this classification, innovations can be classified in the manner in which these are combined.

- The distinction between ‘invention’ and ‘innovation’ is an important one. According to Wikipedia, ‘An inventor is a person who creates or discovers a new method, form, device or other useful means.’ An invention is the practical and material embodiment of a concept or idea. For an invention to become an innovation, the opportunity has to be exploited. Innovation is the process of doing new things in which a product or service is produced that is judged to be significantly original by the relevant community.
- Innovation implies action, and when the new ideas conceived are transformed into new products, services or processes, it results in an innovation. Commercial exploitation of an original idea is an innovation. Improvements to the idea are re-innovations.
- There are three important people or roles who are part of entrepreneurial activities. They are creative source, champion and sponsors. Creative source refers to the inventor and the originator of the idea. The champion is the entrepreneurial mind. The sponsor may be an investor (such as, a venture capitalist), or an organization that provides corporate resources for the innovative project and their champions.
- Creativity is an indispensable element in entrepreneurship. Entrepreneurs do not need to be creative themselves, but their involvement in the creative process is essential to translate ideas into realistic and useful applications.
- Creativity involves the ability to take existing objects and combine them for new purposes in various ways. Creativity also involves the translation of our unique talents, gifts, and vision into an external reality that is new and useful.
- Convergent thinking is the intellectual ability to logically evaluate, critique and choose the best idea from a selection of ideas.
- Divergent thinking is the intellectual ability to think of many original, diverse and elaborate ideas.
- Some of the important innovations that left a global impact are the integrated circuit, the Internet, microprocessors, USB, smartphone and quantum computers.

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11.7 KEY WORDS

- **Inventor:** It is a person who creates or discovers a new method, form, device or other useful means.
- **Creativity:** It refers to the ability to take existing objects and combine them for new purposes in various ways. Creativity also involves the translation

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of our unique talents, gifts, and vision into an external reality that is new and useful.

- **Convergent thinking:** It is the intellectual ability to logically evaluate, critique and choose the best idea from a selection of ideas.
- **Divergent thinking:** It is the intellectual ability to think of many original, diverse and elaborate ideas.

11.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Define innovation.
2. Differentiate between creativity and innovation.
3. Write a short note on the importance of creativity and innovation.
4. What is the difference between divergent thinking and convergent thinking?

Long-Answer Questions

1. Discuss the prominent classification systems of innovations.
2. Explain the seven conditions that are critical to successful innovations.
3. Examine some of the prominent innovations that left a global impact.

11.9 FURTHER READINGS

Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.

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BLOCK - IV
SMALL ENTERPRISES AND RECENT
DEVELOPMENT

Family Enterprises

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UNIT 12 FAMILY ENTERPRISES

Structure

- 12.0 Introduction
- 12.1 Objectives
- 12.2 Meaning of Family Enterprises
 - 12.2.1 Stages of Transformation
 - 12.2.2 Family Management Practices in India
 - 12.2.3 Issues in Family Business
 - 12.2.4 Planning Process
 - 12.2.5 Future of Family Business
- 12.3 Answers to Check Your Progress Questions
- 12.4 Summary
- 12.5 Key Words
- 12.6 Self Assessment Questions and Exercises
- 12.7 Further Readings

12.0 INTRODUCTION

Family business refers to a business where the ownership and management remains with a family unit. A family business goes through three broad stages of transformation, namely, the Controlling Owner stage, the Sibling Partnership stage and the Cousin Consortium stage. As the family business goes through these three stages, it grows in size and becomes more complex. In India, family management practices have been in vogue since long. It forms the backbone of the Indian economy. While there are several advantages, family businesses also have several limitations. This unit will discuss the key issues in family business and the future prospects of family business.

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the concept of family enterprises
- Explain the stages of transformation of a family business
- Examine family management practices in India
- Discuss the issues of family businesses and succession planning
- Analyse the future prospects of family business

12.2 MEANING OF FAMILY ENTERPRISES

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According to the Collins English Dictionary and the Thesaurus, 'family' can be defined as 'parent and children or near relatives'. A family business is a business whose ownership and management is concerned with the family unit. According to Shanker and Astrachan (1996), the dimensions of a family business includes information about:

- Percentage of ownership
- Power over strategic decisions
- Voting control
- Involvement of multiple generations;
- Active management of family members.

According to the Australian Family and Private Business Survey of 1997, a business can be called a family business when any one or more of the four following conditions are satisfied;

- A single family group efficiently controls the business.
- More than 50% of the ownership is held by a single family.
- The bulk of senior management is drawn from the same family.
- More than 50% of the ownership is held by more than one family.

Advantages of the Family Business

According to Leach (1996), the following are the advantages enjoyed by family firms:

- Reliability and pride building strong relationships with customers.
- Specialist knowledge and know-how protected and retained by the family.
- Commitment through family ties.
- Free advice from experienced family members.
- Cultural long-term stability and positivity relative to non-family firms.
- Extensive business and social networks.
- Extensive knowledge of markets, suppliers etc.
- Family usually willing to advance loans at zero or low interest.
- Short-lines of communication allows fast decision-making.
- 'Flexible' repayments.
- Initial passion of founder may be transferred inter-generationally.
- Resilience of family members during times of crisis.
- Long-range planning although not necessarily of the 'formal type'; and
- Employment flexibility in terms of time and effort and whether to accept a full salary all of the time especially when business is not performing.

However, like every business, family businesses also have their own problems, the most apparent being favouritism. This conflict within the family has a negative impact on the venture. The various steps that can be taken to resolve family conflict are:

1. The first step is to address the critical issues relating to family involvement in the business, i.e., how does the business relate to the family and vice versa.
2. Establish a family council to express views and set ground rules.
3. Construct a family constitution by developing a written statement of the family's values, beliefs and objectives.
4. Monitoring progress and maintaining regular communication through council meetings.

Though in real life managing a family conflict is not as smooth as stated above, but these steps are important and should be given attention.

12.2.1 Stages of Transformation

An examination of family business system development in 1997 led Kelin E. Gersick and others to come up with the Three Stages of Development of the Family Business, first published in the book *Generation to Generation: Life Cycles of the Family Business*. This framework describes the typical categories and path that a family company moves along over the course of time. It gives an understanding of the strengths and challenges of family companies at each stage so we can be more prescriptive about the future course of action that the families can adopt.

The first stage is the Controlling Owner stage. Most families start at this stage with the focus being on one owner (or one owner and his/her spouse) who have ownership control. A family business can remain in this stage for many generations if ownership remains with one person or a married couple. At this stage, the family is relatively small and family relationships can be intense. The business is the focus of the family's life. The founder is impressive and is often considered indispensable as he builds a lot of value and is typically at the center of activity.

In the second stage which is the Sibling Partnership stage, the ownership passes on to the next generation. At this stage, brothers and sisters control the business together through ownership. Families become large and diverse, and businesses become more complex. The company is dependent on the sibling team to work efficiently and effectively. Family relationships can be less connected as siblings create their own nuclear families. Some of the common problems faced at this stage are concerned with sibling rivalry around power and fairness, balancing of dividends with reinvestment, and building of professional systems in the business.

Following the second stage, family businesses typically move to the Cousin Consortium stage as ownership control is now transferred to a group of cousins. The family is larger and more diverse. The business has also at this stage become larger and more complex. Typically, few family members are employed in the business at this stage. Non-family members often manage the business while the family gravitates to board roles. With a large family, maintaining unity and

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organization in the family is important. In addition cousin families often face the issues of accepting branch differences, managing the psychological impact of wealth on families, maintaining aggressive reinvestment in the business, and redefining the family mission for a large family.

12.2.2 Family Management Practices in India

Family business has been prevalent in India since long, but slowly and gradually the nature and structure of family business has changed. India ranks third in terms of the numbers of the family owned businesses. Excluding Japan, more than 50 per cent of the top performing businesses in Asia is from India. Large corporate business houses like TATAs, Ambanis, Godrej, Bajaj, Hinduja, Ruia, Mittal, Thapar, Adani, Birla, Jindal, Mahindra, and many more continue to be run by the respective families, where the role of family patriarch is revered and can be compared to the Emperor Model in a family business.

Family owned organizations have grown in India to the extent that it has become a large part of the Indian society. They form the backbone of the Indian economy and societal growth. It is to be noted that family-owned business do struggle with challenges, but they are able to overcome it and survive. They have time and again shown better performances than public and multinational companies. The financial performance of family owned businesses such as revenue growth, gross margins, earnings before interest, tax depreciation, reserves is far better than the non-family owned businesses.

12.2.3 Issues in Family Businesses

In the era of technological innovation and digitization, family businesses can no longer continue with their old traditions and methodologies. Traditional mindsets need to be jettisoned.

The operational methodology in the businesses has changed for its own survival. There have been changes in the family dynamics and the businesses as well. With the increase in the business size, the business families faced difficulty in managing the operations and mobilizing resources for continuity. Due to this, the financial control of the businesses slowly and gradually shifted from the promoters to the financial institutions.

Family businesses need to find a balance between profits and maintaining family relationships. One of the challenges faced by family business is ownership management and creating professionalization with great transparency. Lack of communication between different members of a family, too much control by the family patriarch, lack of written or agreed family policies, etc. can be detrimental to the family business. This is because it can hamper career growth of the family members and the employees.

Many family businesses were established in the late 1980s and early 1990s, when several economic reforms were introduced. Today, most of the founders are on the verge of retirement, with no succession plan either from within the family or outside. More than 5 per cent of the global family CEOs do not have a

formal retirement plan and around 75 per cent of the global family businesses do not have a formal succession plan. This has led to bitter relationships and poor decision-making within the family.

Many business families have separated and partitioned for internal peace and better management control. While some have succeeded and branched out, others have failed and collapsed totally. Since 1970s, family businesses have been splitting quite rapidly. Birla's, Tata's, Modi's Walchand's, Singhanias, Mafatlal's, Shriram's, Thapar's, Sarabhai's, Goenka's, Ambani's, have gone through the splits.

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12.2.4 Planning Process

Succession planning refers to the process of pinpointing key needs for leadership and intellectual talent throughout the organization over time and preparing individuals for present and future work responsibilities. In a family business, succession planning involves:

- Strategic planning,
- Financial planning,
- Estate planning, and
- Human resources planning

Succession planning is done at the individual, family and business levels.

Typically, family business owners consult professionals while developing their succession plans. These professionals can be lawyers, accountants, bankers, financial planners, insurance advisors, merger and acquisition consultants and management consultants. Too often, the professionals find it difficult to proceed because their client has yet to make a number of personal and family decisions that will drive the planning process.

12.2.5 Future of Family Business

Family businesses usually generate a negative impression. This is because it is assumed that family businesses are less formally run, experience power struggles and impositions, and are more profit centred. However, several big businesses that have been successful and profitable are actually family businesses. Most family businesses are geared towards growth and expansion. A lot of them have attained optimal economies of scale in a single generation. Future prospects for family businesses include improving the quality of their workforce, investing in new machinery, regional expansion, and diversification. There are a few factors common to family-run businesses that may help attain these objectives.

Outside investments increase pressure on a company to bend or compromise with the interest of the investors. Investments come with a price as it should not only benefit the recipient but the donor as well. This is not applicable to family business as they function differently. Family businesses want to prolong the longevity of their business so that the benefits can be reaped by children and grandchildren. They are therefore wary of investments as it decreases their ownership of the company and also forces them to work with people they are not comfortable with.

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As far as the employees are concerned, working for family businesses also has its marked advantages. In the present scenario, better standards of living has motivated people to live comfortably across different jobs. People are no longer aiming for mere survival. What matters now is whether the employees are happy working for a company or not. A lot of research relates job satisfaction to an employee's ability to contribute to a noble purpose. This is now a plus for family businesses because the leaders of the company espouse common family values that are imparted to employees.

Furthermore, family corporations tend to run flat organizations and employees have a more direct connection to the business leaders. There is less bureaucracy, which has paved the way for quick decisions. The companies do not have to schedule meetings with numerous investors in order to make important decisions. Response to market conditions is also quicker for family businesses. Moreover, family members formulate business strategies, most of the time. The company executives therefore deal with the operational tasks while the owners of the business strategize to protect their family's investment.

In addition to this, family businesses are more likely to make environment-friendly and community-beneficial decisions in comparison to other corporations. The business decisions of family businesses reflect on their personal reputation in their social circles and the place of their residence. Any negative image attributed to the company is also attributed to them personally. Therefore, families who own businesses tend to weigh in the interests of stakeholders in their strategies more than other businesses.

Family business, nevertheless, must always assess their way of doing business. They should be careful not to be trapped in the same pitfalls associated with family-run enterprises. Some owners of family corporations tend to stay in leadership too long and as a result their more conservative approach shuns innovation and new technologies. They do not want to be dictated to by the younger generation, who in turn are also very respectful and submissive given the success of their predecessor. At times, it is also hard to separate family matters from business decisions. Decisions in family businesses tend to be more personal and subjective, at times, at the expense of favouring less deserving employees over the more talented ones.

It should take a healthy balance between these advantages and disadvantages to push family corporations forward.

Check Your Progress

1. What are the conditions that needs to be fulfilled in order to be qualified as a family business?
2. State the disadvantages of a family business.
3. In which book was the concept of the three stages of development of a family business first discussed?

4. What are the three stages of development of family business?
5. What are some of the common problems faced at the Sibling Partnership stage?
6. Name some of the family businesses in India that have undergone a split.
7. Define succession planning.

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12.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A business can be called a family business when any one or more of the four following conditions are satisfied:
 - o A single family group efficiently controls the business.
 - o More than 50% of the ownership is held by a single family.
 - o The bulk of senior management is drawn from the same family.
 - o More than 50% of the ownership is held by more than one family.
2. Family businesses have their own disadvantages, the most apparent being favouritism. This conflict within the family has a negative impact on the venture.
3. The three stages of development of family business was first discussed in the book *Generation to Generation: Life Cycles of the Family Business*.
4. The three stages family business goes through are the Controlling Owner stage, Sibling Partnership stage and the Cousin Consortium stage.
5. Some of the common problems faced at the Sibling Partnership stage are concerned with sibling rivalry around power and fairness, balancing of dividends with reinvestment, and building of professional systems in the business.
6. Birla's, Tata's, Modi's Walchand's, Singhania's, Mafatlal's, Shriram's, Thapar's, Sarabhai's, Goenka's, Ambani's, have undergone a split.
7. Succession planning refers to the process of pinpointing key needs for leadership and intellectual talent throughout the organization over time and preparing individuals for present and future work responsibilities.

12.4 SUMMARY

- A family business is a business whose ownership and management is concerned with the family unit. According to the Australian Family and Private Business Survey of 1997, a business can be called a family business when any one or more of the four following conditions are satisfied;
 - o A single family group efficiently controls the business.
 - o More than 50% of the ownership is held by a single family.

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- o The bulk of senior management is drawn from the same family.
- o More than 50% of the ownership is held by more than one family.
- The three stages family business goes through are the Controlling Owner stage, Sibling Partnership stage and the Cousin Consortium stage.
- The first stage is the Controlling Owner stage. Most families start at this stage with the focus being on one owner (or one owner and his/her spouse) who have ownership control. In the second stage which is the Sibling Partnership stage, the ownership passes on to the next generation. At this stage, brothers and sisters control the business together through ownership. Following the second stage, family businesses typically move to the Cousin Consortium stage as ownership control is now transferred to a group of cousins. The family is larger and more diverse. The business has also at this stage become larger and more complex.
- Family business has been prevalent in India since long, but slowly and gradually the nature and structure of family business has changed. India ranks third in terms of the numbers of the family owned businesses. Family owned organizations have grown in India to the extent that it has become a large part of the Indian society. They form the backbone of the Indian economy and societal growth.
- In the era of technological innovation and digitization, family businesses can no longer continue with their old traditions and methodologies. One of the challenges faced by family business is ownership management and creating professionalization with great transparency. Lack of communication between different members of a family, too much control by the family patriarch, lack of written or agreed family policies, etc. can be detrimental to the family business. Lack of retirement plans or succession plan is also a concern.
- Succession planning refers to the process of pinpointing key needs for leadership and intellectual talent throughout the organization over time and preparing individuals for present and future work responsibilities.
- Family businesses should be careful not to be trapped in the same pitfalls associated with family-run enterprises. Some owners of family corporations tend to stay in leadership too long and as a result their more conservative approach shuns innovation and new technologies. They do not want to be dictated to by the younger generation, who in turn are also very respectful and submissive given the success of their predecessor.

12.5 KEY WORDS

- **Succession planning:** It refers to the process of pinpointing key needs for leadership and intellectual talent throughout the organization over time and preparing individuals for present and future work responsibilities.

- **Tax depreciation:** It is the depreciation that can be listed as an expense on a tax return for a given reporting period under the applicable tax laws. It is used to reduce the amount of taxable income reported by a business.
- **Strategic planning:** It is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy.
- **Human resource planning:** It is a process that identifies current and future human resources needs for an organization to achieve its goals.

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12.6 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Define family business.
2. What are the steps taken to resolve conflicts within a family business?
3. Write a short note on family business in India.
4. What are the future prospects of family business in India?

Long-Answer Questions

1. Discuss the advantages of a family business.
2. Examine the three stages of development of the family business.
3. Explain some of the common issues faced by family businesses.

12.7 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
- Mohanty, S.K. 2005. *Fundamentals of Entrepreneurship*. New Delhi: Prentice Hall of India.
- Desai, Vasant. 1997. *Management of Small Scale Industries*. New Delhi: Himalayan Publishing House.
- Kumar, S. Anil. 2008. *Entrepreneurship Development*. New Delhi: New Age International.

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UNIT 13 RECENT DEVELOPMENTS IN SMALL ENTERPRISES IN INDIA

Structure

- 13.0 Introduction
- 13.1 Objectives
- 13.2 Government Rules and Regulations
- 13.3 Industrial Sickness in India : Reasons for Sickness, Causes and Consequences
- 13.4 Answers to Check Your Progress Questions
- 13.5 Summary
- 13.6 Key Words
- 13.7 Self Assessment Questions and Exercises
- 13.8 Further Readings

13.0 INTRODUCTION

The Government of India has introduced a legal framework for the operation of small scale industries. It effectuated the Industries (Development and Regulation) Act, 1951. Section 11-B and Section 29-B are concerned primarily with the small scale sector. This unit will discuss in detail the provisions of Industries (Development and Regulation) Act, 1951 and the issue of industrial sickness. Industrial sickness in SSIs has slowly and gradually become a cause of concern. It is therefore important to identify that causes of sickness and then take remedial measures to overcome it.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss government rules and regulations for Small Scale Industries
- Explain the concept of industrial sickness
- Examine the causes of industrial sickness and the remedies to overcome it

13.2 GOVERNMENT RULES AND REGULATIONS

The conceptual and legal framework for industrial development and industries in India was provided by The Industries (Development and Regulation) Act, 1951. A number of amendments have been made to the Act in the later years to make it more relevant to the changing conditions.

Section 11-B defines SSIs in terms of: (i) Investment of unit in fixed assets, (ii) Nature of ownership, (iii) Smallness of number of workers employed, and (iv) Nature, cost and quality of product, etc.

Section 29-B provides for reservation of products for exclusive production in the small-scale sector.

The portions of the Act and subsequent notifications for amendments related to the small scale and ancillary industrial undertakings have been reproduced here for reference. The major ones are:

1. Industries (Development and Regulation) Act, 1951.

Explanatory note: The conceptual and legal framework for small scale and ancillary industrial undertakings is derived from the IDR Act, 1951. Section 11 B of the Act specifies the general requirements that are to be complied with by small-scale units. The Section is quoted below:

SECTION 11B

Power of Central Government to specify the requirements which shall be complied with by small scale industrial undertakings:

- (1) The Central Government may, with a view to ascertaining which ancillary and small scale industrial undertakings need supportive measures, exemptions or other favourable treatment under this Act to enable them to maintain their viability and strength so as to be effective in:

Promoting in a harmonious manner the industrial economy of the country and easing the problem of unemployment and securing that the ownership and control of the material resources of the community to serve the common good, having regard to the factors mentioned in sub-section (2), by notified order. The requirements which shall be complied with by an industrial undertaking to enable it to be regarded, for the purposes of this Act, as an ancillary, or a small scale, industrial undertaking and different requirements may be specified for the industrial undertakings engaged in manufacture or production of different articles:

Provided that no industrial undertaking shall be regarded as an ancillary industrial undertaking unless it is or is proposed to be, engaged in the manufacture of parts, components, sub-assemblies, tooling or intermediates; or rendering of services, or supplying or rendering, not less than fifty per cent of its production or its total services, as the case may be, to other units for production of other articles.

- (2) The factors referred to in sub-section (1) are the following, namely: the investment by the industrial undertaking in plant and machinery, and, buildings plant and machinery; the nature of ownership of the industrial undertaking; smallness, in respect of the number of workers employed in the industrial

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undertaking; the nature, cost and quality of the product of the industrial undertaking;

Foreign exchange, if any, required for the import of any plant or machinery by the industrial undertaking; and such other relevant factors as may be prescribed.”

Notifications laying down the precise definition of small-scale industries issued by Government of India under the above Section from time to time. This has generally been done in terms of an investment limit in plant and machinery (calculated at original value.)

The Act specifically refers to only two categories of the small-scale sector:

- Small Scale Industrial undertaking
- Ancillary Industrial Undertaking

Over the years, however, some sub-sectors have been identified within overall small-scale sector. These are: (i) Tiny enterprises, (ii) Export Oriented Units, (iii) Small Scale Service and Business Enterprises (SSSBE), and (iv) Women Enterprises.

In other words, the small-scale sector comprises of small scale and ancillary industrial undertakings. The small-scale units are further categorised as Tiny enterprises, Export Oriented Units, SSSBE and Women Enterprises.

IDR Act also provides for statutory reservation of items/products for exclusive production in the small-scale sector. Such products therefore are reserved for manufacture only in the small-scale sector. The provisions relating to reservation are contained in section 29 B (2 A) to (2H) of the IDR Act. The list of reserved item is appended as Schedule-III of the licensing notification No. S.O. 477 (E) Dt. 25th July, 1991. This list is based on the NIC product classification code (9 digits). At present 812 products are reserved for exclusive production in the small-scale sector. At the 9-digit classification, the number of items is 1075.

The policy of reservation was given statutory backing by an amendment, in the IDR Act in 1984. Section 29B of the Industries Development and Regulation Act, 1951, deals with the policy of reservation in the small-scale sector. The relevant sections are quoted below:

Section 29B

Section 29B of the Industries Development and Regulation Act, 1951, deals with the policy of reservation in the small-scale sector. The relevant sections are quoted below:

2A. In particular and without prejudice to the generality of the provisions of subsection (1), the Central Government may, if it is satisfied, after considering the recommendations made to it by the Advisory Committee constituted under subsection (2B), that it is necessary so to do for the development and expansion

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of ancillary, or small scale industrial undertakings, by notified order, direct that any article or class of articles specified in the First Schedule shall, on and from such date as may be specified in the notified order (hereafter in this section referred to as the 'date of reservation'), be reserved for exclusive production by the ancillary, or small scale, industrial undertakings (hereafter in this section referred to as 'reserved article').

2B. The Central Government shall, with a view to determining the nature of any article or class of articles that may be reserved for production by the ancillary or small scale, industrial undertakings, constitute an Advisory Committee consisting of such persons as have in the opinion of that Government, the necessary expertise to give advice on the matter.

2C. The Advisory Committee shall, after considering the following matters, communicate its recommendations to the Central Government, namely:

The nature of any article or class of articles which may be produced economically by the ancillary, or small-scale industrial undertakings;

The level of employment likely to be generated by the production of such article or class of article by the ancillary, or small-scale, industrial undertakings.

The possibility of encouraging and diffusing entrepreneurship in industry; The prevention of concentration of economic power to the common detriment and such other matters as the Advisory Committee may think fit.

2D. The production of any reserved article or class of reserved articles by any industrial undertaking (not being an ancillary, or small scale, industrial undertaking) which, on the date of reservation, is engaged in, or has taken effective steps for, the production of any reserved article or class of reserved articles, shall after the commencement of the Industries (Development and Regulation) Amendment Act, 1984, or, as the case may be, the date of reservation, whichever is later, be subject to such conditions as the Central Government may, by notified order, specify.

2E. While specifying any condition under sub-section (2D), the Central Government may take into consideration the level of production of any reserved article or class of reserved articles achieved, immediately before the date of reservation, by the industrial undertaking referred to in sub-section (2D), and such other factors may be relevant.

2F. Every person or authority, not being the central Government, who, or which, is registered under section 10 or to whom, or to which, a license has been issued or permission has been granted under section 11 for the production of any article or class of articles which has, or have, been subsequently reserved for the ancillary, or small scale, industrial undertakings, shall produce, such registration certificate, license or permission, as the case may be, within such period as the Central Government may, by notified order, specify in this behalf, and the Central government may enter therein all or any of the conditions specified by it under

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sub-section (2D), including the productive capacity of the industrial undertakings and other prescribed particulars.

2G. The owner of every industrial undertaking (not being an ancillary or small-scale, industrial undertaking) which, immediately before the commencement of the Industries (Development and Regulation) Amendment Act, 1984, or the date of reservation, whichever is later:

Was engaged in the production of any article or class of articles, which has, or have been reserved for the ancillary, or small scale, industrial undertakings, or

Had before such commencement or before the date of such reservation, as the case may be, taken effective steps for commencing the production of such reserved article or class of reserved articles, without being registered under section 10 or in respect of which a license or permission has not been issued under section 11, shall refrain from the production of such reserved article or class of reserved articles, on and from the date of such reservation, whichever is later.

2H. Every notified order made under sub-section (2A) shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days, which may be comprised in one session or in two or more successive sessions aforesaid, both Houses agree in making any modification in the notified order or both Houses agree that the notified order should not be made, the notified order shall thereafter have effect only in such modified form or be of no effect, as the case may be; so however, that any such modification or annulment shall be without prejudice to the validity of anything previous done under that notified order.

(i) Notification No. S.O. 220 (E)/IDRA/29B/75 Dated 19th May, 1975.

In exercise of the powers conferred by sub-section (1) of Section 29B of the Industries (Development and Regulation) Act, 1951 (65 of 1951), the Central Government hereby makes the following further amendments in the notification of the Government of India in the late Ministry of Industrial Development (Department of Industrial Development) No. S.O. 98 (E)/IDRA/29b/73/1, dated the 16th February, 1973, namely.

In the said notification, in term

- (1) For the abbreviation, figure and words '₹ 750 thousand' the abbreviation, figure and words '₹ 1 million' shall be substituted; for item (2), the following item shall be substituted, namely:
- (2) Undertakings having investments in fixed assets in plant and machinery not exceeding ₹ 1.5 million and engaged in:

The manufacture of parts, components, sub-assemblies, tooling or intermediates; or

The rendering of services; and supplying or rendering, or proposing to supply or render 50 per cent of their production or the total services, as the case may be, to other units for production of other articles.

Provided that no such undertaking shall be a subsidiary of, or owned or controlled by any other undertaking.

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(ii) Notification S.O. 48 (E) Dated 19th January, 1980

In exercise of the powers conferred by Sub-Section (i) of Section 29 B of the Industries (Development and Regulation) Act, 1951 (65 of 1951), the Central Government hereby makes the following further amendment to the notification of the Government of India in the late Ministry of Industrial Development (Department of Industrial Development) No. S.O.; 98 (E)/IDRA/29B/73/1 dated the 16th February, 1973 regarding exemptions to certain classes of industrial undertakings, namely:

In the said notification, after item (2) relating to ancillaries, the following provision shall be added, namely:

Provided further that no undertaking referred to in item (1) or (2) above shall be a subsidiary of or owned or controlled by any other undertakings.

(iii) Notification S.O. 202 (E) Dated 18th March, 1985

In exercise of the powers conferred by Sub-Section (1) of Section 29B read with Section 11 B of the Industries (Development and Regulations) Act, 1951 (65 of 1951) the Central Government hereby makes the following further amendments to this Ministry's notification No. S.O. 98 (E)/IDRA/29B/73/1, dated the 16th February, 1973, namely: -

In the said notification:

For the heading 'Small Scale Industrial Undertaking' shall be substituted and under the heading so substituted in item No. 1, for the expression '₹ 2.0 million' the expression '₹ 3.5 million' shall be substituted.

For the heading 'Ancillaries' the heading so substituted in item No. 2, for the expression '₹ 2.5 millions', the expression '₹ 4.5 million' shall be substituted.

(iv) Notification S.O. 232 (E) - Dated 2nd April, 1991.

Whereas the Central Government considers it necessary with a view to ascertain which ancillary and small scale industrial undertakings need supportive measures, exemption or other favourable treatment under the Industries (Development and Regulation) Act, 1951 (65 of 1951), (hereinafter referred to as the said Act) to enable them to maintain their viability and strength so as to be effective in:

Promoting in a harmonious manner the industrial economy of the country and easing the problem of unemployment, and

Securing that the ownership and control of the material resources of the community are so best to subserve the common good.

And whereas the draft notification was laid before each House of Parliament for a period of 30 days as required under sub-section (3) of section 11B of the said Act.

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And whereas no modification in the proposed notification has been suggested by both Houses of parliament.

Now, therefore, in exercise of the powers conferred by sub-section (i) of Section 11B and sub-section (i) of Section 29B of the said Act, and notwithstanding anything contained in any earlier notification issued by this Department, the Central Government hereby specifies having regard to the factors mentioned in the Table below, which shall be complied with by the industrial undertaking for the purposes of the said Act.

I. Requirements to be complied with by an industrial undertaking for being regarded as small scale industrial undertaking:

An industrial undertaking in which the investment in fixed assets in plant and machinery whether held on ownership terms or on lease or by hire purchase does not exceed ₹ 6 million.

In case of an industrial undertaking referred to in (a) above the limit investment in fixed assets in plant and machinery shall be rupees seventy five lakhs provided the unit undertakes to export at least 30 per cent of the annual production by the end of 3rd year from the date of its commencing production.

II. Requirements to be complied with by an industrial undertaking for being regarded as ancillary industrial undertaking-

An industrial undertaking which is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediates, or the rendering of services, and the undertaking supplies or renders or proposes to supply or render not less than 50 per cent of its production or services, as the case may be, at one or more other industrial undertakings and whose investment in fixed assets in plant and machinery whether held on ownership terms or on lease or on hire purchase, does not exceed ₹ 7.5 million.

Every industrial undertaking which has been issued a certificate of registration by the Department of Industrial Development or Director General of Technical Development under the said Act and now falls within the above definition of ancillary or small scale industrial undertaking, may be registered, at the discretion of the owner, as such, within six months from the date of issue of this notification.

(V) Circular 4/91-SSI Bd. Dated 7.5.91

Subject: Enhancement of investment limits in the Small Scale and Ancillary Industrial Undertakings.

The Government had issued a Press Note on 19th March, 1985, raising the investment limits in small scale industrial undertakings from ₹ 2 million to ₹ 3.5 million and for ancillary industrial undertakings from ₹ 2.5 million to ₹ 4.5 million in plant and machinery. Keeping in view the escalation in the cost of plant and machinery since then, Government had been considering the question of upward revision of these investment limits.

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Accordingly, Government had placed a statement in (both Houses) Parliament on 31st May, 1990 outlining certain policy measures to be adopted including enhancement of investment ceiling of small scale/ancillary industrial undertaking. In pursuance of this, a draft notification for changing the definition (enhancing the limits) of small scale/ ancillary industrial undertakings was placed before the Parliament on 7th August, 1990, as per the provisions of Section 11B (3) of the Industries (Development & Regulation) act, 1951. Parliament did not disapprove or modify the draft notification in any way within the period stipulated in Section 11B(3) of 1 (D&R) Act, 1951.

Accordingly, Gazette Notification No. S.O. 232 (E) dated 2nd April, 1991 has been issued (copy enclosed) under sub-section (1) of Section 11B and sub-section (1) of Section 29b of the Industries (Development & Regulation) Act, 1951 enhancing investment limits in fixed assets in plant and machinery, whether held on ownership term or by lease or by hire purchase, for small scale and ancillary industrial undertakings as per details below:

No. Category of Undertakings	Limit in fixed assets in plant and machinery increased investment	
	From	To
a. Small Scale Industrial Undertaking	₹ 3.5 million (\$79 thousand)	₹ 6 million (\$134 thousand)
b. An Industrial Undertaking referred to in (a) above which undertakes to export atleast 30 percent of its annual production by the end of 3rd year from the date of its commencing production	₹ 3.5 million (\$79 thousand)	₹ 7.5 million (\$167 thousand)
c. Ancillary Industrial Undertaking	₹ 4.5 million (\$101 thousand)	₹ 7.5 million (\$167 thousand)

(The investment limit has since been enhanced to ₹ 10 million (\$224 thousand) both in respect of SSI and ancillary industrial undertakings w.e.f. 24.12.1999) The definition for Export oriented units as at (b) above dropped from December 1997.

Besides the criterion of investment ceiling an ancillary industrial undertaking is one which is engaged or is proposed to be engaged in the manufacture or production of parts, components, sub-assemblies, tooling or intermediates of the rendering of services, and the undertaking supplies or renders or proposes to supply or render not less than 50 per cent of its production or services, as the case may be, to one or more other industrial undertakings.

An undertaking within the investment limits in plant and machinery under different categories and other requirements mentioned above would now be exempt

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from the licensing provisions of the Industries (Development & Regulation) Act, 1951. The various conditions and stipulations regarding industrial licensing mentioned notification No. S.O. 629 E dated 30th June, 1988 would, however, continue operate except for investment ceiling for SSI which have now been revised. This will also, be subject to the condition that such an undertaking shall not be a subsidiary or owned or controlled by any other undertaking.

Certain clarifications and explanations have been issued from time to time by the Government regarding computation of investment in fixed assets in plant and machinery of a small scale/ancillary industrial undertaking. These would continue to hold good and are reproduced below for the sake of convenience.

In calculating the value of plant and machinery, the original price paid by the owner, irrespective of whether the plant and machinery are new second hand, will be taken into account.

The cost of equipment such as tools, jigs, dies, moulds and spare parts for maintenance and the cost of consumable stores will be excluded computing the value of plant and machinery. Similarly, the cost installation of plant and machinery will also be excluded.

The cost of R&D equipment and pollution control equipment will be excluded in computing the value of plant and machinery.

In the case of imported machinery, import duty will be included, but not the miscellaneous expenses like transportation from the port to the site the factory, demurrage if any paid at the port and premium if any paid for import entitlement or import of machinery. However, shipping charges, customs clearance charges and sales tax should be included in computing the cost of plant and machinery.

The cost of generation sets, if any, installed will be excluded. Similarly, the cost of extra transformer, etc. which has to be installed by a unit as per the regulations of State Electricity Board would also be excluded.

The bank charges and services charges paid to the National Small Industries Corporation or to the State Small Industries Corporation will be excluded in computing the cost of plant and machinery.

The cost involved in procurement/installation of cables, wiring bus-bars, electrical control panels (not those mounted on individual machines), OCBs/MCBs etc.; which are necessarily to be used for imparting electrical power to the plant & machinery/safety measures is not to be taken into account for computing the cost of plant and machinery for determining the status of an industrial undertaking.

Cost of gas producer plant will be excluded.

Consequent upon upward revision of investment ceiling in fixed assets in plant and machinery of small scale/ancillary industrial undertaking, procedural formalities in certain specific situations envisaged are also clarified as under:

Industrial undertakings which have crossed the limit of ₹ 3.5 million (\$79 thousand) in the case of small scale industrial undertakings and ₹ 4.5 million (\$101

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thousand) in the case of ancillary industrial undertakings, but fall within the revised investment limit and are holding industrial license or have got themselves registered with DGTD or other technical authorities on or before the date of the notification raising the investment limits, will be treated as small scale undertakings and ancillary undertakings, as the case may be. Such undertakings will have an option to be transferred to the State Directorate of Industries or to continue with DGTD. This option will have to be exercised within six months from the date of the notification. However, in the meanwhile (i.e. upto a period of six months) these undertakings will continue to receive their raw material assistance through the DGTD. However an Industrial undertaking exercising the option to continue with the DGTD or the concerned technical authority, will not be entitled for the incentives and concessions which are extended to small-scale undertakings.

Small Scale and ancillary undertakings which were granted carrying - on - business licenses on crossing of the investment limits prescribed prior to the date of the notification, would now eligible to be treated as small scale undertakings and ancillary undertakings, in accordance with the revised definition, if they fall within the revised investment limits. The COB licenses in their cases will be treated as dormant.

In the case of undertakings which had crossed the previous investment limits prior to the date of notification and applied for COB license, they will no longer be required to obtain COB license provided their case falls within the enhanced limits, now fixed for small scale and ancillary undertakings. No further action would be taken on their COB applications. They will continue to be treated as small scale/ ancillary undertakings.

The undertakings which had crossed the previous investment limits (of ₹ 6 million (\$134 thousand)/ ₹ 7.5 million (\$167 thousand)) prior to the date of notification raising the present limit and which had neither obtained nor applied for COB license, as was required under existing law, would have breached the provisions of the Industries (Development and Regulation) Act, 1951. In view of the fact that they now qualify for treatment as small scale and ancillary Government have decided to treat such breach as a technical breach only and to condone their non-compliance with the provisions of the industries (Development & Regulation) Act, 1951 during the period for which they might have crossed the previously laid down investment limits and under which they would require COB license provided their cases fall within the enhanced limits now fixed for small scale/small scale with at least 30 percent exports/ancillary undertakings.

An industrial undertaking which has crossed the limit of ₹ 6 million (\$134 thousand) prior to the date of the notification, but has exported at least 30 per cent of its production in the previous year and falls within the revised investment limit of ₹ 7.5 million (\$167 thousand) for exporting units and has got itself registered with DGTD or other technical authorities, on or before the date of the notification raising the investment limit will be treated as small scale industrial undertaking.

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Such undertaking will have an option to be transferred to the State Directorate of Industries or to continue with DGTD. This option will have to be exercised within six months from the date of notification. However, in the meanwhile (i.e., up to a period of six months) these undertakings will continue to receive their raw material assistance through the DGTD. However, an industrial undertaking exercising the option to continue with the DGTD or the concerned technical authority, will not be entitled for the incentives and concessions, which are extended to small-scale undertakings.

In case of industrial undertakings which graduate to medium scale units by process of natural growth will get raw material assistance from DGTD, for a period of six months from the date of registration/grant of industrial license/COB license at the same level as earlier approved by the Director of Industries/DC (SSI).

All units which cross the limit of investment as now prescribed in the definition of small scale/ancillary undertakings by process of natural growth will need registration with DGTD or other technical authorities. The units engaged in the manufacture of such items which are not eligible for exemptions from licensing provisions in terms of any earlier notification issued by the Department of Industrial Development (e.g. units engaged in the manufacture of items exclusively reserved for small scale sector, units requiring foreign exchange for import of components and raw materials in excess of the prescribed limits and industries requiring special regulation) will need a 'carrying-on-business' license before crossing this limit. Such units will have to submit their applications in the prescribed manner to the Secretariat for Industrial Approvals. In granting the registration DGTD/Technical authorities, or the COB license, the export obligation on such units consistent with the policy or protection to the small scale sector.

Directors of Industries will keep a special watch over the units which are about to cross the upper limits of the definition so as to enable a smooth transfer of units from the Directorate of Industries to DGTD/technical authorities and that the units take timely action to obtain the COB licenses, wherever necessary. However, if a small scale unit wishes to have some more time for the transfer to the DGTD list, a grace period up to 2 years will be allowed during which period it will continue to enjoy all the facilities under the small industries programme. A special report on such units will be made by the Directors of Industries to the Development Commissioner, Small Scale Industries.

Monitoring of the export obligation will be done by the office of the Chief Controller of Imports & Exports.

Notification S.O. 2(E) Dated 1.1.1993

Whereas the Central Government considers it necessary with a view to ascertaining which ancillary and small scale industrial undertakings need supportive measures exemptions or other favourable treatment, under the Industries (Development and Regulation) Act, 1951 for the purposes specified in Section 11-B of the said Act:

And whereas the draft Notification was laid before each House of Parliament for a period of 3-0 days as required under Sub-Section (3) of Section 11-B of the Said Act.

And whereas no modification in the proposed Notification has been suggested by both Houses of Parliament.

Now, therefore, in exercise of the powers conferred by sub-section (1) of Section 11-B and Sub-Section (1) of Section 29-B of the said Act, the Central Government for the purpose of further specifying the requirements which shall be complied with by the industrial undertakings to enable them to be regarded as an ancillary or a small scale industrial undertaking for the purposes of the said Act, makes the following amendments in the Notification of the Govt. of India in the Ministry of Industry (Department of Industrial Development) No. S.O. 232 (E) dated the 2nd April, 1991 namely:

In the said Notification, in the Table, in paragraph-II the existing note shall be numbered as Note-I thereof and after Note-1, as so numbered, the following explanation and Note shall be inserted, namely:

Explanation: For the purposes of this Note:

- (A) 'Owned' shall have the meaning as derived from the definition of the expression 'owner' specified in clause (f) of Section-3 of the Industries Development & Regulation) Act, 1951 (65 of 1951).
- (B) 'Subsidiary' shall have the same meaning as in clause (47) of Section 2, read with Section 4, of the Companies Act, 1956 (1 of 1956).
- (C) The expression 'controlled by any other industrial undertaking' means as under:

Where two or more industrial undertakings are set up by the same person as a proprietor, each of such industrial undertakings shall be considered to be controlled by the other industrial undertaking or undertakings.

Where two or more industrial undertakings are set up as partnership firms under the Companies Act, 1956 (1 of 1956), an industrial undertaking shall be considered to be controlled by other industrial undertaking if:

Where industrial undertakings are set up by Companies under the Companies Act, 1956 (1 of 1956), an industrial undertaking shall be considered to be controlled by other industrial undertaking if:

The equity holding by other industrial undertaking in it exceeds 24 per cent of its total equity, or

The management control of an undertaking is passed on to the other industrial undertaking by way of the Managing Director of the first mentioned undertaking being also the Managing director or Director in the other industrial undertaking or the majority of Directors on the Board of the first

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mentioned undertaking being the equity holders in the other industrial undertaking in terms of the provisions of (a) and (b) of sub clause (iv):

- (D) The extent of equity participation by other industrial undertaking or undertakings in the undertaking as per sub-clause (iii) above shall be worked out as follows:

The equity participation by other industrial undertaking shall include both foreign and domestic equity.

Equity participation by other industrial undertaking shall mean total equity held in an industrial undertaking by other industrial undertaking or undertakings, Whether small scale or otherwise, put together as well as the equity held by persons who are Directors in any other industrial undertaking or undertakings.

Equity held by a person, having special technical qualification and experience, appointed as a Director in a small scale industrial undertaking, to the extent of qualification shares, if so provided in the Articles of Association, shall not be counted in computing the equity held by other industrial undertaking or undertakings even if the person concerned is a Director in other industrial undertaking or undertakings.

- (E) Where an industrial undertaking is a subsidiary of or is owned controlled by any other industrial undertaking or undertakings in terms of sub-clause (i) sub clauses (ii), or sub-clause (iii), and if the total investment in fixed assets in plant and machinery of the first mentioned industrial undertaking and the other industrial undertaking or undertakings clubbed together exceeds the limit of investment specified in paragraph I or II of this Table as the case may be, none of these industrial undertakings shall be considered to be a small scale or ancillary industrial undertaking.....

1. Circular No. 4(1)/92-SSI Bd. (4) Dated 17th May, 1993: The notification No. S.O. 2 (E) dated 1st January, 1993 provides definition and explanation of the terms 'owned', 'subsidiary' and 'controlled' in their application to Small Scale Industries. This, in effect, prescribes the method to determine whether a Small Scale Industrial undertaking is owned, controlled or is a subsidiary of any other industrial undertaking under the IDR Act, 1951.
2. Although the notification is quite clear in its intent and explanation, even then a large number of queries have been received from various quarters asking for clarification in respect of the notification. The confusion is mainly in the area of 'control' and 'clubbing' contained in the explanation C (i) to (V) of the said notification. Queries regarding interpretation have been raised, among others, by individual units, associations, State Govts. and some Govt. departments.

3. Broadly, the following type of questions have been raised: Whether a company not engaged in industrial activity can invest more than 24% in a small scale industrial undertaking?

What is the extent to which an NRI can invest in a small-scale industrial undertaking?

What is the permissible extent of participation by a foreign company in a small-scale industrial undertaking?

Whether the Managing Director of a company owning an industrial undertaking can set up a proprietary or partnership concern in the small scale?

4. All issues relating to the questions that have been raised have been examined in this office. The notification is quite clear on this subject and ordinarily the Licensing Authorities should have been able to determine and decide on the above question. However, since there seems to be some confusion over interpretation, following clarification is being issued interpreting the various implications of the provisions of the notification.

(a) It should be understood that industrial undertaking is different from its form of ownership. The forms of ownership as stated in the notification are of three types viz., proprietary, partnership and company. As per clauses, C (i) C (ii) and C (iii) of the notification the provisions of 'controlled' and 'clubbing' will apply only to similar forms of ownership, of industrial undertakings, e.g., an industrial undertaking owned by a proprietary concern cannot be clubbed with one owned as a company OR an industrial undertaking owned by a partnership firm cannot be clubbed with an industrial undertaking owned as a proprietary concern irrespective of the concerned persons (proprietor, partner or equity holder) being common. In other words, in the above examples the provisions of 'controlled' and 'clubbing' will not apply.

(b) Clarification in respect of Clause C (iii) is as follows: A Company will be considered as having set up an industrial undertaking only if it has an equity interest (i.e. invested in equity) in an industrial undertaking. In other words, a company with no equity interest in any industrial undertaking can invest in a small-scale unit without such equity being counted as equity by other industrial undertaking. Thus, in the first instance, such a company can invest even more than 24 per cent equity in a small-scale industrial unit. However, no sooner the company acquires an equity interest in an industrial undertaking it becomes a company that has set up an industrial undertaking. Therefore, in the second or

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subsequent instances the equity investment by such a company will count towards equity by other industrial undertaking and the provisions of clubbing will apply.

Similarly, a NRI can invest in the first instance in a small-scale industrial unit without such equity being counted as equity by other industrial undertaking. Thus, in the first instance the equity investment can be more than 24 per cent, even 100 per cent. However, in the second or subsequent instances, the provisions of 'clubbing' will start to apply.

Similarly, a foreign company with no equity interest in an industrial undertaking, whether in India or abroad can, in the first instance, invest equity of any amount in a small-scale industrial undertaking. However, in the subsequent instances, the provisions of 'clubbing' will apply because such a company would, after the first investment, be considered as having set up an industrial undertaking.

5. The above clarification should, normally, answer all the queries that have been raised by various quarters. You are requested to take decisions regarding provisions of 'controlled' in the light of the clarifications made above. You are also requested to bring it to the notice of all registering authorities.

Micro, Small and Medium Enterprises Development Act, 2006

For the promotion and development of micro, medium and small enterprises, Micro, Small and Medium Enterprises Development Act, 2006 was passed.

The Ministry of Micro, Small and Medium Enterprises succinctly defines:

The Micro; Small and Medium Enterprises Development (MSMED) Act was notified in 2006 to address policy issues affecting MSMEs as well as the coverage and investment ceiling of the sector. The Act seeks to facilitate the development of these enterprises as also enhance their competitiveness. It provides the first-ever legal framework for recognition of the concept of "enterprise" which comprises both manufacturing and service entities. It defines medium enterprises for the first time and seeks to integrate the three tiers of these enterprises, namely, micro, small and medium. The Act also provides for a statutory consultative mechanism at the national level with balanced representation of all sections of stakeholders, particularly the three classes of enterprises; and with a wide range of advisory functions. Establishment of specific funds for the promotion, development and enhancing competitiveness of these enterprises, notification of schemes/programmes for this purpose, progressive credit policies and practices, preference in Government procurements to products and services of the micro and small enterprises, more effective mechanisms for mitigating the problems of delayed payments to micro and small enterprises and assurance of a scheme for

easing the closure of business by these enterprises are some of the other features of the Act.

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1. What is Section 11-B of the Industries (Development and Regulation) Act, 1951 concerned with?
2. What does Section 29-B of the Industries (Development and Regulation) Act, 1951 state?
3. What are the two broad categories into which small-scale sector is categorized?
4. What are the sub-sectors identified within the small-scale sector?

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13.3 INDUSTRIAL SICKNESS IN INDIA : REASONS FOR SICKNESS, CAUSES AND CONSEQUENCES

The prevalence of sickness in SSI sector is a cause of concern. The definition of sickness in SSI Sector has been undergoing changes. The Reserve Bank of India (RBI) was instrumental in appointing Committees from time to time to look into the issue of the Sickness affecting the Sector. The latest definition of Sickness given by the Working Group on Rehabilitation of Sick Units set up by the RBI (Kohli Committee) is given as:-

‘A small scale industrial unit is considered sick when

(a) if any of the borrowal accounts of the unit remains substandard for more than six months, i.e., principal or interest, in respect of any of its borrowal accounts has remained overdue for a period exceeding one year will remain unchanged even if the present period for classification of an account as substandard is reduced in due course; OR

(b) There is erosion in the net worth due to accumulated losses to the extent of 50 percent of its net worth during the previous accounting year, and (c) The unit has been in commercial production for atleast two years.’

Criteria to identify Sickness/Incipient Sickness

The necessary information on sickness and incipient sickness among the Units in the Sector was collected during the Third Census. In order to measure incipient sickness, the continuous decline in gross output for three consecutive years was identified as a suitable indicator, whereas for measuring sickness, the latest definition given by the Kohli Committee was adopted. Thus, the following criteria were adapted to identify sick/ incipient sick units in the Third Census.

- (i) Continuous decline in gross output compared to the previous two financial years;

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- (ii) Delay by more than 12 months in repayment of loan taken from institutional sources; and
- (iii) Erosion in the net worth to the extent of 50 percent of the net worth during the previous accounting year.

Magnitude of Sickness/Incipient Sickness

Sickness identified in the Registered SSI Sector in terms of delay in repayment of loan or erosion in the net worth was of the order of 2.5 %, whereas in the Unregistered SSI Sector, it was 0.78 %.

Out of the units having loan outstanding with Institutional Sources like Banks and Financial Institutions, sickness was about 14.08 % in the Registered SSI Sector as against 13.47 % in the case of Unregistered SSI Sector. Incipient sickness identified in terms of continuous decline in gross output was of the order of 13.01 % in the Registered SSI Sector and 7.76 % in the Unregistered SSI Sector. Combining the three yardsticks used to measure sickness, viz;

- (a) delay in repayment of institutional loan over one year,
- (b) decline in net worth by 50 %, and
- (c) decline in output during last three years, about 14.47 % of the units in the Registered SSI Sector were identified to be either sick or incipient sick, while this percentage was only 8.25 in the case of unregistered units.

Causes

Important causes of sickness in SSIs/SSUs are as follows:

- **Inadequacy of working capital:** Some units turn out sick due to inadequacy of working capital. There may exist delay in sanction of working capital by financial institutions. Industrial units find it difficult to meet out day to day operations due to the time gap between sanction of term loan and working capital needs. Shortage of working capital is one of the main reasons for sickness.
- **Non-availability of raw material:** Some units may require raw material which are scarcely available. Sometimes, the raw material required by the unit may not be available in abundance. Hence, this affects the production and the sales of the goods. If the raw material is not abundantly available, then the industrial units have to spend a large amount of money to buy them. This may result in financial loss.
- **Non-availability of credit:** Sickness in SSI sector may be attributed to non-availability of credit. Delay in getting loans may result in stoppage of work or lead to production loss. Low production may lead to reduced sales which in turn may lead to financial loss.
- **Marketing problems:** Sometimes, the industrial units may not know as to how to create demand for the products. Lack of marketing knowledge may

result in less demand for the goods. Similarly, there may be less demand for the goods produced by the SSI due to competition or change in the taste of the buyer.

- **Diversion of resources:** If the employer utilizes the funds obtained for the business for any personal purposes, then diversion of funds will lead to industrial sickness. The funds used for personal purposes cannot be regenerated and hence it may result in delay in payment of loans or financial crisis for the borrower of the loan.
- **Poor and obsolete technology:** Some industrial units use technology which is outdated. Out dated technology may affect the quantity and quality of production. This results in production loss and reduces demand for the goods.
- **Erratic power supply:** Shortage in power supply affects the industries. This results in delay in production of goods and leads to financial losses.
- **Labour problems:** The relationship between the employer and the employees may not be cordial. Some of the labour problems such as strike, lay off, lock out may lead to industrial sickness.
- **Poor Management:** The entrepreneur must be a good planner, organizer and a manager. If the Industrial Unit promoters lack managerial skills, then it may lead to several problems.
- **Dispute among partners:** There may arise dispute between the partners or family members running the unit. This results in stoppage of work and leads to industrial sickness.
- **Inadequate attention to R&D:** Industries have to allocate a part of money in research and development to survive and compete with competitors. Failure to focus on the above may lead to industrial sickness.
- **Globalization:** Small scale industrial units may find it very difficult to compete with large scale industries and foreign competitors. Inability of the units to face growing competition due to liberalization and globalization may lead to industrial sickness.

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Remedies

Some of the remedial measures to curb and overcome sickness in industrial undertakings are as follows:

- **Identifying sickness at initial stage:** Sickness in small scale industries are not a sudden phenomenon but it is a gradual process taking 5 to 7 years eroding the health of a unit beyond cure. Therefore, the identification and detection of the sickness at incipient stage is the first and foremost measure to detect and reduce industrial sickness. Sickness must be identified at initial stage.

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- **Financial assistance:** Lending agencies need to relax their lengthy process and other norms for extending credit to the SSIs. To combat the incidence of sickness financial institutions should grant credit without delay to SSI sector.

A number of initiatives can be undertaken to overcome credit problems such as:

- Increasing Working capital limit.
- Enhancing the powers of bank managers of specialized bank branches in offering credit to SSI.
- Strengthening the mechanism for discounting bills.
- Reduced rate of interest.

These measures would improve the flow of credit and keep a check on the incidence of sickness.

- **Improving infrastructure:** Infrastructure facilities can be improved by setting up industrial estates. Common testing centres etc., infrastructural problems can be solved by improving the roadways, waterways, establishing telecommunication systems.
- **Technology up-gradation:** Funds may be provided by the financial institutions for adoption of advanced technology. Similarly, some sort of training may be provided for use of the latest technology to overcome technological problems. Technological up-gradation can help to overcome technological obsolescence.
- **Marketing assistance:** Marketing assistance may be provided to entrepreneurs for marketing the goods produced by them. Government must help to market the goods. Government and Non-Government Organizations (NGOs) can come forward for marketing the goods produced by the SSI sector. The problem of poor marketing of the products can be solved by coordinated efforts of entrepreneurs and promotional agencies.
- **Government interventions:** Interventions must be made by the government to prevent sickness. Periodic review of financial statements can help to identify and prevent sickness at initial stage.
- **Training:** A proper environment must be created where an entrepreneur will be educated and will have a proper knowledge, skill and experience about internal and external environment of business to compete with large-scale industries and multinational companies.
- **Rehabilitation:** Potentially viable sick units should be dealt well for the purpose of rehabilitation. Rehabilitation is a remedy considered for industrial units, which have already become sick and for the units that are on the verge of collapse. Under the provisions of SICA, 1985, the Government of India has established Board for Industrial and Financial Reconstruction (BIFR) in

January 1987 for determining the preventive, ameliorative, remedial and other measures which are required to be taken in respect of sick industrial company and for expeditious enforcement of rehabilitation schemes.

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5. Under what conditions is a small scale industrial unit considered sick?
6. State any two remedial measures taken to curb sickness in industrial units.
7. When was the Board for Industrial and Financial Reconstruction (BIFR) established?

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13.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Section 11-B defines SSIs in terms of: (i) Investment of unit in fixed assets, (ii) Nature of ownership, (iii) Smallness of number of workers employed, and (iv) Nature, cost and quality of product, etc.
2. Section 29-B provides for reservation of products for exclusive production in the small-scale sector.
3. The two categories of the small-scale sector are Small Scale Industrial Undertaking and the Ancillary Industrial Undertaking.
4. The sub-sectors identified within small-scale sector are: (i) Tiny enterprises, (ii) Export Oriented Units, (iii) Small Scale Service and Business Enterprises (SSSBE), and (iv) Women Enterprises.
5. A small scale industrial unit is considered sick when (a) if any of the borrowal accounts of the unit remains substandard for more than six months, i.e., principal or interest, in respect of any of its borrowal accounts has remained overdue for a period exceeding one year will remain unchanged even if the present period for classification of an account as substandard is reduced in due course; OR (b) There is erosion in the net worth due to accumulated losses to the extent of 50 percent of its net worth during the previous accounting year, and (c) The unit has been in commercial production for atleast two years.
6. The remedial measures to curb and overcome sickness in industrial units are as follows:
 - Identifying sickness at initial stage
 - Providing financial assistance
7. The Board for Industrial and Financial Reconstruction (BIFR) was established in January 1987.

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13.5 SUMMARY

- The conceptual and legal framework for industrial development and industries in India was provided by The Industries (Development and Regulation) Act, 1951. A number of amendments have been made to the Act in the later years to make it more relevant to the changing conditions.
- Section 11-B defines SSIs in terms of: (i) Investment of unit in fixed assets, (ii) Nature of ownership, (iii) Smallness of number of workers employed, and (iv) Nature, cost and quality of product, etc.
- Section 29-B provides for reservation of products for exclusive production in the small-scale sector.
- A small scale industrial unit is considered sick when (a) if any of the borrowal accounts of the unit remains substandard for more than six months, i.e., principal or interest, in respect of any of its borrowal accounts has remained overdue for a period exceeding one year will remain unchanged even if the present period for classification of an account as substandard is reduced in due course; OR (b) There is erosion in the net worth due to accumulated losses to the extent of 50 percent of its net worth during the previous accounting year, and (c) The unit has been in commercial production for atleast two years.
- Some of the prominent causes of sickness in SSIs are inadequacy of working capital, non-availability of raw material, marketing problems, diversion of resources, obsolete technology, erratic power supply, etc.
- The remedial measures to curb and overcome sickness in industrial units are as follows:
 - o Identifying sickness at initial stage
 - o Providing financial assistance
- A number of initiatives can be undertaken to overcome credit problems such as:
 - o Increasing Working capital limit.
 - o Enhancing the powers of bank managers of specialized bank branches in offering credit to SSI.
 - o Strengthening the mechanism for discounting bills.
 - o Reduced rate of interest.

13.6 KEY WORDS

- **Working capital:** It is the difference between a company's current assets, such as cash, accounts receivable (customers' unpaid bills) and inventories

of raw materials and finished goods, and its current liabilities, such as accounts payable.

- **Globalization:** It is the process of interaction and integration among people, companies, and governments worldwide due to advancements in transportation and communication technology.
- **Rehabilitation:** It is a remedy considered for industrial units, which have already become sick and for the units that are on the verge of collapse.

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13.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the criteria used to identify sick units?
2. Write a short note on the remedial measures that can be taken to curb sickness in industrial units.
3. What are some of the initiatives taken to overcome credit problems?
4. Write a short note on rehabilitation of sick units.

Long-Answer Questions

1. Discuss in detail Section 11-B and Section 29-B of the Industries (Development and Regulation) Act, 1951.
2. Explain the causes of sickness in SSIs.
3. Examine the measures that can be taken to improve the flow of credit in SSIs.

13.8 FURTHER READINGS

Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.

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UNIT 14 FRANCHISING AND RURAL ENTREPRENEURSHIP

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Structure

- 14.0 Introduction
- 14.1 Objectives
- 14.2 Franchising: Types, Advantages and Disadvantages
 - 14.2.1 Evaluation of Franchise Arrangement
- 14.3 Rural Entrepreneurship
 - 14.3.1 Need for Rural Entrepreneurship
 - 14.3.2 Problems of Rural Entrepreneurship
 - 14.3.3 SHGs and Rural Development
- 14.4 Answers to Check Your Progress Questions
- 14.5 Summary
- 14.6 Key Words
- 14.7 Self Assessment Questions and Exercises
- 14.8 Further Readings

14.0 INTRODUCTION

Franchising is a unique way of doing business in which there is an arrangement between the franchisor (the owner of the business providing the product or service) and the independent entrepreneur (the franchisee). The Franchisor authorizes the franchisee to sell their products, goods, services and gives rights to use their trademark and brand name. This unit will discuss the advantages, types and disadvantages of franchising. Another crucial aspect of entrepreneurship that needs consideration is rural entrepreneurship. There is a need for an integrated approach to rural entrepreneurship. This unit will discuss the problems of rural entrepreneurship and the role played by SHGs.

14.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the types, advantages and disadvantages of franchising
- Explain the key aspects of evaluation of franchise arrangement
- Discuss the need for rural entrepreneurship and role of SHGs
- Examine the problems faced by rural entrepreneurs

14.2 FRANCHISING: TYPES, ADVANTAGES AND DISADVANTAGES

Franchising is not a business in itself, but a way of doing business. It is essentially a marketing concept introducing an innovative method of manufacturing and

distributing goods and services. Franchising is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to an independent entrepreneur (the franchisee) the legal right to manufacture, market and distribute the franchisor's goods or services using the brand name for an agreed period of time. The International Franchise Association defines franchising as a continuing relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing training, merchandising and management in return for a consideration from the franchisee. Franchising has become popular because it allows a much greater degree of control over the marketing efforts in the foreign country. In franchising, product lines and customer services are standardized, two important features from a marketing perspective, though cultural differences might require adaptation. Franchising can offer people looking at self-employment a greater chance of success than starting their own businesses, but it is a path that many people are not aware is open to them. A franchisor's main ongoing commitment to his franchisees is to provide support. A support programme should be well defined prior to joining a given franchise group and is likely to cover areas such as staff issues, marketing and system compliance.

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Types

Four models of franchising:

- *Manufacturer-Retailer*: Where the retailer as the franchisee sells the franchisor's product directly to the public (e.g. Automobile dealerships).
- *Manufacturer-Wholesaler*: Where the franchisee manufactures and distributes the franchisor's product under license (e.g. Soft drink bottling arrangements).
- *Wholesaler-Retailer*: Where the retailer as the franchisee purchases products for retail sale from a franchisor wholesaler (e.g. Hardware equipment and automotive product stores).
- *Retailer-Retailer*: Where the franchisor markets a service, or a product, under a common name and standardized system, through a network of franchisees.

The first two categories cited above are often referred to as product and trade name franchises. These include arrangements in which franchisees are granted the right to distribute a manufacturer's product within a specified territory or at a specific location, generally with the use of the manufacturer's identifying name or trademark, in exchange for fees or royalties.

The business format franchise, however, differs from product and trade name franchises. This method implies the use of the franchisor's format, or a comprehensive system for the conduct of the business, including such elements as business planning, management system, location, appearance and image, and quality of goods.

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Advantages

There are many benefits of becoming a franchisee of which the major ones are listed below:

- The franchisor provides detailed consultation and training in operating the business as well as choosing locations for the business.
- The franchisee benefits from operating under the established brand image and reputation of the franchisor.
- The franchisees usually need less capital than they would if they were setting up a business independently because the franchisors, through their pilot operations and buying power, would have eliminated unnecessary expenses.
- The franchisor helps the franchisee obtain occupation rights to the trading location, comply with planning (zoning) laws, prepare plans for layouts, plan ergonomics and refurbishment, and provides general assistance in calculating the correct level and mix of stock for the opening launch of the business.
- The franchisee taps into the bulk purchasing power and negotiating capacity made available by the franchisor by virtue of the size of the franchised network.
- The franchisee has access to use of the franchisor's patents, trademarks, copyrights, trade secrets, and any secret processes or formulae.
- The franchisee has the benefit of the franchisor's continuous research and development programmes, which are designed to improve the business and keep it up-to-date and competitive.

Disadvantages

One of the drawbacks of franchising is the need for careful and continuous quality control. Such close supervision of the various aspects of distant operations requires well-developed global management systems and labour-intensive monitoring. Inevitably, the relationship between the franchisor and franchisee must involve imposition of controls. These controls will regulate the quality of the service or products to be provided or sold by the franchisee to the consumer. As a lot of managerial skills are required, international franchising has been successful largely among those enterprises which have already had long experience with franchising at home.

14.2.1 Evaluation of Franchise Arrangement

Let us examine some other considerations when first evaluating a franchise opportunity:

- **Market:** Has a defined market been determined? Is that market in growth mode or is it in decline? Understanding with complete certainty who a

company will serve helps to determine the viability, and ultimately the profitability, of the franchise.

- **Company History:** Researching the officers and management of the franchise along with those who will be supporting the business should provide some insight on the franchise's culture.
- **Financial Statements:** Reviewing financial statements is vital.
- **Level of Investment:** All franchise companies will look at liquid capital (sometimes known as the capital required) assets-to-liabilities, and net worth.
- **Training and Support:** One should look for a support and training system that is comprehensive and has done away with any outdated procedures.
- **Royalties:** The franchise should be making money on its royalties, not by providing owners with 'other' services. Many of these other services are to third-party vendors and constitute a pass-along expense.
- **Suitability:** A franchise agreement lasts generally anywhere from 5 to 15 years. It is very expensive to back out once one has signed the agreement. Suitability encompasses a personal inventory of a company's core strengths and skills, and whether or not it will fit with the franchise culture.
- **Exit Strategy:** Planning on how one would exit, whether that would be selling or transferring the business. Keep in mind there are costs to both so one should ask about those costs upfront.

Check Your Progress

1. Define franchising.
2. List the four main models of franchising.
3. What is the major drawback of franchising?

14.3 RURAL ENTREPRENEURSHIP

Entrepreneurs who set up rural-based industries or in rural areas are called rural entrepreneurs. Examples of such industries are the khadi or village industry sectors. The Khadi and Village Industry Commission (KVIC) Act says that rural industries are those industries, which are located in the area where population does not exceed 10,000 and the wages of the workers do not exceed ₹ 1,000. The Government of India has modified this definition of rural entrepreneurs as follows: 'Any industry located as village industries in a rural area, village or town with a population of 20,000 and below and an investment of ₹ 3 crore in plant and machinery is classified as village industries.'

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14.3.1 Need for Rural Entrepreneurship

An integrated approach to rural industrialization calls for giving priority to the organized development of artisans – a formidable task beset with problems are not as simple as they often appear to be. They live in scattered places and do not constitute a homogeneous group. Their problems vary from place to place although the products may be the same. Their productivity is unremuneratively low, and the standard of their products is not always suitable for wider acceptability. Their input supply system is irregular and fragile, and the market is restricted. And above all, these artisans live in so much of want that their socio-economic needs keep them permanently as wage-earners almost in bondage to some middlemen. Unless their consumption needs and other social exigencies are properly taken care of, they cannot really come up as independent entrepreneurs. The incentives and assistance given to them often fail because the training programmes fail to provide for the varying needs of the artisans. Many artisans just cannot attend design development training programmes because they can neither afford to stay out of daily wage-earning routine and face financial crisis. Sometimes, they sell their highly value added works of art at throw away prices to middlemen because they can neither afford to wait for long nor can they take them to the right market. As a result they choose to work as daily wage-earners and the profit of their highly value-added items accrues to the middleman who employs the capital. What we need, therefore, is not a set of incentives or concessions but an enveloping support to the entrepreneurs in the backward areas which can reasonably cater to their varying individual and social needs. Besides providing for their needs, the strategy should be to establish cooperative societies or government agencies to provide raw materials to help them in making and marketing their products. However since they stay scattered, it is not easy to organize rural market centers under this strategy on a regular basis. It is, therefore, necessary that the supplies from this sector should be given preferential status in marketing and it necessary, competition from big manufactures has to be banned. In that case the total demand for such products in a region will have to be met from this artisan sector and more people can be inducted into this sector to increase output and even the underemployment of the existing artisans would disappear. For example, if simple agricultural implements are only in the artisan sector, the total demand of a region can give so much work that the artisans no longer remain in financial crisis. The only problem is to organize this vast network to touch each atomic unit. But all this has to be done if the backward areas are to be easily awakened. According to J.M. Muller ‘It is not argued that the village metal smiths and tin smiths should be promoted for any nostalgic or romantic reasons. On the contrary, these craftsmen, if supported, constitute a basis for rural industrialization which will otherwise be wasted and by rural industrialization is not meant the establishment of any industries in rural areas, it means the establishment of enterprises that are lined backward and forward to other productive activities within the rural communities’.

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Appropriate technical and consultancy organizations must work constantly to introduce appropriate technological innovations to increase productivity without displacing labour. New designs and improvements can be introduced for decorative crafts to cater to sophisticated markets which are ever widening. It is just enough to allow the artisans to survive but to make them increasingly relevant to the changing needs. If more efficient agricultural implements are available, no one would buy old-fashioned implements, simply because they are the products of the artisans. It would also not be proper to upgrade their skill so as to enable them to produce more efficient equipments without adopting the stylistic changes and needs. Otherwise, the market for these products would quickly shrink. However, it is not so easy to introduce these innovative changes among the illiterate or semi-literate artisans. In order to do this, we have to create active linkages between research organizations and these artisans on a permanent basis. Training programmes have to be organized which must expose their inadequacies and teach them to assimilate the innovative ideas. Also, this cannot be done unless their tradition, skill and quality of work are studied in depth and imaginative training programmes designed. Similarly, arrangement has to be made to market their products. Organizations sponsored by the government should initially buy their products in order to ensure quick payment to the artisans and then release the profit when the product is ultimately sold to the real customer.

A location is defined as rural if at least seventy-five percent of the population is agrarian. There is no universal definition for rural society. Marketing activities are highly influenced on entrepreneurial development in any area, if there is no sufficient marketing opportunities for a product or services no entrepreneur is dare to launch business in the particular area. Rural marketing activities are related to agricultural products. Some people regard it as an activity related to marketing of artisan and cottage industry products. However, rural marketing is being popularly understood at present by most of the management experts relates to marketing of various goods and services to rural areas. However, in a broader sense, rural marketing covers all those marketing activities where rural people are involved as participants in the marketing system i.e., producers, buyers, middlemen, etc.

In the last ten years, there has been tremendous development in the rural areas. The government has spent crores of rupees in development. The various government schemes, which are intended to provide employment of 100 days to one person from each rural family, will ensure that more money to flows into the rural India than ever before. Other government initiatives including road building, rural electrification, making banks to lend to farmers, enhances educational facilities to rural people. These steps are helping the children of the farmers in getting city jobs and sending money home. With the current boom in private sector, industry and services have over taken farming to account for 54 percent of rural income.

Rural Entrepreneurial Opportunities

These opportunities exist mainly in three sectors, which are as follows:

- 1. **Primary Sector:** Cultivation of food grains and commercial crops in own land or in leased basis, dairy farming, cattle rearing, fish culture, poultry and meat production.
- 2. **Secondary Sector:** Cottage and village industries, quarrying, construction ubiquities such as bricks, sand and cement or steel frameworks.
- 3. **Tertiary Sector:** Wholesale and retail sales, hotels, transport, community and social services establishments.

Male			Female		
Primary	Secondary	Tertiary	Primary	Secondary	Tertiary
757	102	141	885	66	49

Source: National Sample Survey from “Introduction to Rural Marketing” R. Krishna Moorthy, Himalaya Publishing, page: 14

It is seen from the table that about 75% of rural population is engaged in agricultural and allied occupations. However, there is a shift towards secondary and tertiary occupations especially in large villages and villages situated close to cities and towns. As a result of better connectivity, the acceleration of the ongoing shift away from agricultural employment into higher value-added activities in manufacturing and services. Data collected by the National Sample Survey Organization (NSSO) over more than a decade shows that the proportion of male rural workers employed in agriculture has already declined from 75 percent to 67 percent. Some of them are shifting to self employment by setting up small shops to meet their village communities. The service sector has picked up the major share in providing entrepreneurial opportunities in the areas of construction raw material selling, trading services, hotels and restaurants, transport, storage and communication have expanded significantly. Coming to the manufacturing sector, rural areas are increasing in the line of agricultural tools, steel works, food processing, textile, FMGC products job processing industries and are showing the greatest path to the young rural entrepreneurs. As education levels in rural India continue to rise, the country’s new and relatively better-educated potential entrepreneurs are likely to turn towards entrepreneurship that use their education and offer them a way out the poverty of subsistence agricultural. Falling communications and transport cost will also enable new business-production models in rural centers.

Consumer centric philosophy is increasingly followed by many companies in the world as a powerful means of business success; it has to be applicable for entrepreneurs’ success even in the rural areas. Now-a-days rural entrepreneurs

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are being able to understand consumer behaviour and mould their entrepreneurial activities accordingly. The large part of the products and services that are available to the urban consumers are not accessible to rural consumers. Many companies tried to reach the rural consumers but were forced to satisfy with marginal success. The entrepreneurial strategies proved success in urban markets did not yield similar results in rural markets. Hence, it is understood that there is lot of scope and opportunity for entrepreneurs in rural area, all it depends on the interest of potential entrepreneurs in identification of opportunities and capture them in a successful way.

14.3.2 Problems of Rural Entrepreneurship

Some of the major problems faced by rural entrepreneurs are as follows:

1. **Financial Problems:** Some of the major financial problems faced by rural entrepreneurs are paucity of funds, lack of infrastructural facilities and very less risk bearing capacity.
2. **Marketing Problems:** Some of the major marketing problems faced by rural entrepreneurs are stiff and severe competition from large sized organizations and urban entrepreneurs. These have better financial resources to compete. In addition, literacy rate is one among many major problems faced by rural entrepreneurs and they should device strategies and remedies to solve it. Further, rural entrepreneurs are heavily dependent on middlemen for marketing of their products who necessarily pocket large amount of profit.
3. **Management Problems:** Some of the major management problems are a lack of knowledge of information technology as rural entrepreneurs rely on internal linkages which encourage the flow of services, goods, ideas and information. In addition, in complying with various legal formalities and in obtaining licenses rural entrepreneurs find it extremely difficult due to ignorance and illiteracy. Rural entrepreneurs to a major extent also suffer a severe problem of lack of technical knowledge. Lack of training facilities and other extensive services create a hurdle for the development of rural entrepreneurship. Another important problem is growth of rural entrepreneurship is the inferior quality of products produced due to lack of availability of standard tools and other equipment as well as poor quality of raw materials
4. **Human Resource Problems:** Some of the major human resource problems found in organization are low skill level and high turnover of workers. Most of the entrepreneurs working in rural areas have to provide employees with on the job training which is difficult and costly. Another problem is a lack of support structure. Sometimes the environment in the family, society and support system is not much conducive enough to encourage rural people to take up entrepreneurship as a career. It may

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be certainly due to lack of awareness and knowledge of entrepreneurial opportunities.

14.3.3 SHGs and Rural Development

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The SHG model has evolved in the NGO sector and works on the belief that the poor can help themselves with the NGOs providing the required networking and education. These groups have a common perception of need for collective action. SHGs are small (membership 10 to 20) informal groups that have socially and economically homogeneous membership of poor people drawn from the same village or from nearby villages. The members are self-selected, meaning that the potential members join a group of their choice depending on the level of their affinity to fellow members. Thus the basic design of the SHG is robust and makes it easy for the NGOs to build it into a strong social and financial institution.

NABARD defines SHG as ‘a group of 20 or less people from a homogeneous class who are willing to come together for addressing their common problems. They make regular savings and use the pooled savings to give interest-bearing loans to their members. The process helps them imbibe the essentials of financial intermediation including prioritization of needs, setting self-determined terms for repayment, and keeping books and records. It builds financial discipline and credit history that then encourages banks to lend to them in certain multiples of their own savings and without any demand for collateral security.’

The concept of SHG mainly revolves around the causes that project self-help as a means to mitigate the problems faced by a set of people. The concept of SHG can be traced to the collection of people to form informal groups to overcome the problems related to a particular negative status.

SHGs are the voluntary response of the poor to their marginalization – social, economic and political. Generally, SHGs are accepted as an informal group of people who have a common perception of need and impulse towards collective action.

Similarly, Singh has defined SHGs as voluntary associations of people formed to collectively perform certain activities of common interest. The SHG, both by definition and in practice, is a group of individuals who, by free association, come together for a common collective purpose. SHGs comprise members known to each other, coming from the same village, community and even neighbourhood. That is, they are homogeneous and have certain pre-group social binding factors. The SHGs collect a fixed amount as savings from each member regularly (it depends upon the constitution of the group mostly weekly, fortnight or monthly). Generally, for about six months, they only collect thrift; no loan is given to their members. Firstly, the working fund generated out of small thrift is negligible in the initial period; secondly it tests the patience and tries to inculcate mutual trust among the members of the group. During this initial period the groups are expected to open a savings bank account in a nearby branch of a formal bank. After accumulating a reasonable

sum, the fund is rotated as credit among the members through self-generated norms. Hence, the basis of the SHG is the mutual trust in depositing individual savings in a group account if the claimants are large in number and resources are scarce. This forces them to take an appropriate decision (even credit rationing) to identify the most needy person with regard to endowment level and the purpose of the loan. The democratic discussions and decisions of the members in the group screens and selects the borrower. The joint liability of the group provides incentive or compels the group to undertake the burden of selection, monitoring and enforcement of the borrowers. As the group gains experience, rules and norms pertaining to its functioning get stronger and more institutionalized. Even in the long run the working fund generated by the group may not be adequate to meet all types of productive and non-productive needs of the members. The group then approaches the bank or MFI for external funds. These lending institutions then appraise the working of the SHG and if they are satisfied, term loans of smaller amounts are extended in the initial years. The prompt repayment of loans leads to access to larger (progressive lending) loans to the group. Even though conceptually micro-finance-based SHG is fairly simple, its management in a sustainable manner is quite complex and investment intensive.

Self-help group is a method of organizing or institutionalizing the poor people and the marginalized to come together to solve their individual or family or social problem. The SHG method is used by the government, NGOs and others across the world for various purposes starting from empowerment to economic stability. The poor collect their savings from the peer members and save it in formal financial institutions like banks. As a result, in return they receive easy access to loans with a rate of interest without any prescribed purpose for loan.

Thousands of the poor and the marginalized population in India are building their lives, their families and their society through Self-help groups.

What are SHGs?

- SHGs are group for development group by and for the poor and marginalized people.
- It is accepted by the government and does not require any formal registration.
- The purpose of the SHG is to build the functional capacity of the poor and the marginalized in the field of employment and income generating activities through social capital.
- People are responsible citizens through active participation in social and political issues.

Guiding Principles for the Success of the SHGs

- The strong belief by the individual members to bring about change through collective participation and efforts.

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- Effort is built on mutual trust and mutual support between and across members and network institutions.
- Every individual is equal and responsible in the group for availing the benefits and equal distribution across the members.
- Every individual member is committed to the cause of the group.
- Decision is based on the principles of mutual consensus and cooperation of the members.
- The belief and commitment by an individual member that through the group their standard of living will improve Savings is the foundation on which to build the group for collective action.

Features of the SHGs

- An SHG is socially and economically homogeneous group formed through a process of self-selection based upon the affinity of its members.
- Most SHGs in India are women's groups (from very poor and vulnerable community) with membership ranging between 10 and 20.
- SHGs functions with well-defined rules and by-laws of groups hold regular meetings and maintain records and savings and credit discipline.
- SHGs are self-managed institutions characterized by collective action/ participation and collective decision making.

Policy Issues/Challenges before SHGs in India

The Self-Help Group (SHG) model is the leading form of micro-finance approach in India. Although the term self-help group is used in different countries to describe a variety of financial and non-financial associations, in India it refers to a group of 10-20 poor women who band together for micro-financial services – beginning with periodic, compulsory savings and then mainly loans – and sometimes social services as well. SHGs are managed by their peer members, with varying degrees of outside support. SHGs are formed with the assistance of self-help promotion institutions (SHPIs), which may include non-governmental organizations (NGOs), government agencies, banks, cooperatives, and micro-finance institutions. In addition to helping with group formation, SHPIs provide training, monitoring, and other support services. Occasionally, promoters give SHGs initial seed capital to lend, but more typically, groups begin by saving and lending out their members' own resources. Most, but by no means all, SHGs eventually borrow from an external source, usually a bank. This bank linkage is the most distinctive characteristic of the Indian SHG model.

Characteristic features of Self-Help Groups (SHGs) and the norms for their linkage with banks were first enumerated in the guidelines of NABARD circular dated 26 February 1992. Almost three decades hence the SHG-Bank Linkage Programme (SHG-BLP) continues to be the mainstay of the Indian micro-finance scene.

However, despite the unique characteristics of SHGs and noteworthy accomplishments, the following policy issues/challenges continue to affect the programme in many areas:

- Inadequate outreach in many regions
- Delays in opening of SHG accounts and disbursement of loans
- Impounding of savings by banks as collateral
- Non-approval of repeat loans even when the first loans were repaid promptly
- Multiple membership and borrowings by SHG members within and outside SHGs
- Limited banker interface and monitoring

The biggest example of SHGs being used in India is the Deendayal Antyodaya Yojana:

- Aajeevika - National Rural Livelihoods Mission (NRLM) was launched by the Ministry of Rural Development (MoRD), Government of India in June 2011. Aided in part through investment support by the World Bank, the Mission aims at creating efficient and effective institutional platforms of the rural poor, enabling them to increase household income through sustainable livelihood enhancements and improved access to financial services.
- NRLM set out with an agenda to cover 7 Crore rural poor households, across 600 districts, 6000 blocks, 2.5 lakh Gram Panchayats and 6 lakh villages in the country through self-managed Self Help Groups (SHGs) and federated institutions and support them for livelihoods collectives in a period of 8-10 years. In November 2015, the program was renamed Deendayal Antayodaya Yojana (DAY-NRLM).

As per the Annual report of the Ministry of Rural Development: 'During the FY 2019-20, the DAY-NRLM mission has mobilized 6.47 lakh rural poor households into 58.67 lakh Self Help Groups.

Check Your Progress

4. Give examples of rural-based industries.
5. What are some of the financial problems faced by rural entrepreneurs?

14.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Franchising is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to an independent entrepreneur (the franchisee) the legal right to manufacture, market and distribute the franchisor's goods or services using the brand name for an agreed period of time.

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2. The four main models of franchising are given below:
 - Manufacturer-Retailer
 - Manufacturer-Wholesaler
 - Wholesaler-Retailer
 - Retailer-Retailer
3. The major drawback of franchising is the need for careful and continuous quality control. Such close supervision of the various aspects of distant operations requires well-developed global management systems and labour-intensive monitoring. Inevitably, the relationship between the franchisor and franchisee must involve imposition of controls.
4. Examples of rural-based industries are the khadi or village industry sectors.
5. Some of the major financial problems faced by rural entrepreneurs are paucity of funds, lack of infrastructural facilities and very less risk bearing capacity.

14.5 SUMMARY

- Franchising is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to an independent entrepreneur (the franchisee) the legal right to manufacture, market and distribute the franchisor's goods or services using the brand name for an agreed period of time.
- The four main models of franchising are given below:
 - o Manufacturer-Retailer
 - o Manufacturer-Wholesaler
 - o Wholesaler-Retailer
 - o Retailer-Retailer
- One of the drawbacks of franchising is the need for careful and continuous quality control. Such close supervision of the various aspects of distant operations requires well-developed global management systems and labour-intensive monitoring. Inevitably, the relationship between the franchisor and franchisee must involve imposition of controls.
- Entrepreneurs who set up rural-based industries or in rural areas are called rural entrepreneurs. Examples of such industries are the khadi or village industry sectors. The Khadi and Village Industry Commission (KVIC) Act says that rural industries are those industries, which are located in the area where population does not exceed 10,000 and the wages of the workers do not exceed ₹ 1,000.
- There is a need for an enveloping support to the entrepreneurs in the backward areas which can reasonably cater to their varying individual and

social needs. Appropriate technical and consultancy organizations must work constantly to introduce appropriate technological innovations to increase productivity without displacing labour.

- Rural marketing covers all those marketing activities where rural people are involved as participants in the marketing system i.e., producers, buyers, middlemen, etc.
- Some of the major problems faced by rural entrepreneurs are financial problems, marketing problems, management problems and human resource problems.
- The concept of rural development can be conceptualised as a process, a phenomenon, a strategy and a discipline. As a process it refers to the commitment and engagement of rural communities to fulfil their goals of enhanced well-being. As a phenomenon, rural development is the outcome of several interactions that takes place between various physical, technological, economic, social and institutional factors. As a strategy, it is the combination of various ways that leads to overall development of the rural areas, people and communities.

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14.6 KEY WORDS

- **Franchising:** It is a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to an independent entrepreneur (the franchisee) the legal right to manufacture, market and distribute the franchisor's goods or services using the brand name for an agreed period of time.
- **Royalties:** They are payments to owners of property for use of that property. It often deals with payments for the right to use intellectual property (IP), such as copyrights, patents, and trademarks.
- **Rural Entrepreneurs:** Entrepreneurs who set up rural-based industries or in rural areas are called rural entrepreneurs.
- **SHGs:** It is a financial intermediary committee usually composed of 10 to 20 local women or men between 18 to 40 years.

14.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on rural entrepreneurship.
2. What are some of the problems faced by rural entrepreneurs?

3. Write a short note on the Block SGSY Committee.
4. What are the major components of the DAY-NULM?

Long-Answer Questions

1. Discuss the advantages of franchising.
2. Explain the key considerations that need to be kept in mind while evaluating a franchise opportunity.
3. Analyse the key achievements of the Deendayal Antyodaya Yojana-National Urban Livelihoods Mission.

14.8 FURTHER READINGS

- Khanka, S. S. 2013. *Entrepreneurial Development* (Fourth Revised & Millennium Edition) New Delhi: Sultan Chand & Sons Publishers.
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