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ENTREPRENEURSHIP

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SYLLABI-BOOK MAPPING TABLE

Entrepreneurship

Syllabi	Mapping in Book
BLOCK I: BASICS OF ENTREPRENEURSHIP **Unit 1:** Introduction to Entrepreneurship: Meaning and concept of entrepreneurship, the history of entrepreneurship development, role of entrepreneurship in economic development, agencies in entrepreneurship management and future of entrepreneurship. **Unit 2:** The Entrepreneur: Meaning of entrepreneur, the skills required to be an entrepreneur, the entrepreneurial decision process, and role models, mentors and support system. **Unit 3:** Business Opportunity Identification: Business ideas, methods of generating ideas, and opportunity recognition. **Unit 4:** Preparing a Business Plan: Meaning and significance of a business plan, components of a business plan, and feasibility study.	**Unit 1:** Introduction to Entrepreneurship **(Pages 1-16);** **Unit 2:** The Entrepreneur **(Pages 17-32);** **Unit 3:** Business Opportunity Identification **(Pages 33-45);** **Unit 4:** Preparing a Business Plan **(Pages 46-60)**
BLOCK II: FINANCING AND LAUNCHING OF NEW VENTURE **Unit 5:** Financing the New Venture: Importance of new venture financing, types of ownership securities, venture capital, types of debt securities, determining ideal debt-equity mix, and financial institutions and banks **Unit 6:** Launching the New Venture: Choosing the legal form of new venture, protection of intellectual property, and marketing the new venture. **Unit 7:** Managing Growth in New Venture: Characteristics of high growth new ventures, strategies for growth, and building the new venture capital **Unit 8:** Business ideas – project identifications and formulations –classifications – Project feasibility study – projects appraisal methods-product designs network analysis – financial analysis.	**Unit 5:** Financing the New Venture **(Pages 61-78);** **Unit 6:** Launching the New Venture **(Pages 79-94);** **Unit 7:** Managing Growth in New Venture **(Pages 95-110);** **Unit 8:** Business Ideas **(Pages 111-158)**
BLOCK III: INSTITUTIONAL DEVELOPMENTS OF ENTREPRENEURS **Unit 9:** Financing Entrepreneur – Institutional finance to Entrepreneurs – role of IDBI –IFCI-ICICI- IRCI-SIDBI-LIC-SFC-TIIC-Commercial banks in financial role. **Unit 10:** Promoting Enterprise –SSI-Role and growth of SSI – Regulation governing SSI-incentives and concessions - sickness and causes and remedial. **Unit 11:** Institutional Developments of Entrepreneurs- role of DIC –SISI –SIDCO– NSIC- NAYE- KVIC-TCDS-ITCOT and Entrepreneurial guidance bureau - Incentives and subsidies to Entrepreneurs problems and prospectus EDP-for developing women and rural Entrepreneurs- Entrepreneurial motivation.	**Unit 9:** Financing Entrepreneurs **(Pages 159-177);** **Unit 10:** Promoting an Enterprise **(Pages 178-203);** **Unit 11:** Institutional Development of Entrepreneurs **(Pages 204-233)**
BLOCK IV: ENTREPRENEURIAL CULTURE **Unit 12:** Harvesting Rewards: Exit strategies for entrepreneurs, bankruptcy, and succession and harvesting strategy **Unit 13:** Programmes for Developing Entrepreneurship: Entrepreneurship development programmes – Seed Capital assistance – Capital subsidy - Backward area development schemes – Sales tax concessions – Energy concessions – Recent trends. **Unit 14:** Entrepreneurial Culture – Entrepreneurial Society – Intrapreneurship.Meaning- Importance – Implication – Need–Types- Scope, Features Management of change- Special Programmes of assistance to Entrepreneurship	**Unit 12:** Harvesting Rewards **(Pages 234-248);** **Unit 13:** Programmes for Developing Entrepreneurship **(Pages 249-259);** **Unit 14:** Entrepreneurial Culture **(Pages 260-270)**

CONTENTS

INTRODUCTION

NOTES

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.

A person who invests his resources to perform an economic activity is an entrepreneur. Entrepreneurs share certain common characteristics that include ability to work hard, desire to succeed, innovativeness, risk-taking and a vision. It is common to associate the process of entrepreneurship with uncertainty, especially when introducing something that does not have a market yet. Therefore, an entrepreneur needs to be able to seize the right business opportunity after proper research, planning and with sufficient financial backing. In India, there are various support agencies and institutions that offer start-up entrepreneurs with financial assistance, technology and information.

A study of the concept of entrepreneurship includes discussion of topics like concept, history and role of entrepreneurship, concept of business opportunity identification, financial aspects of a new venture, institutional aid to entrepreneurship as well as nuances of entrepreneurship culture.

This book, *Entrepreneurship,* is written with the distance learning student in mind. It is presented in a user-friendly format using a clear, lucid language. Each unit contains an Introduction and a list of Objectives to prepare the student for what to expect in the text. At the end of each unit are a Summary and a list of Key Words, to aid in recollection of concepts learnt. All units contain Self-Assessment Questions and Exercises, and strategically placed Check Your Progress questions so the student can keep track of what has been discussed.

BLOCK - I
BASICS OF ENTREPRENEURSHIP

NOTES

UNIT 1 INTRODUCTION TO ENTREPRENEURSHIP

Structure

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 history and the role it plays in economic development. It also discusses the agencies involved in entrepreneurship management and gives a glimpse of the future of entrepreneurship management from the Indian perspective.

1.1 OBJECTIVES

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

- Define entrepreneurship
- Discuss the history of entrepreneurship development
- Describe the role of entrepreneurship in economic development
- Discuss the agencies promoting entrepreneurship
- Analyse the future of entrepreneurship in India

1.2 ENTREPRENEURSHIP: MEANING AND CONCEPT

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.

1.2.1 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

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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

1.2.2 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.

1.2.3 Nature

NOTES

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

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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.

1.3 HISTORY OF ENTREPRENEURSHIP DEVELOPMENT

Entrepreneurial growth in any country must evolve within the context of the economic history of that particular country. The study of entrepreneurial growth in India has been divided into three eras, viz, entrepreneurial growth before 1850, from 1850 till Independence, and post Independence.

Entrepreneurial Growth before 1850

Indian industrial entrepreneurship can be traced back to as early as the Vedic period when metal handicrafts were produced. People were organized in an economic and social system, the unit of which was the agricultural village. It consisted of farmers, artisans, Brahmins, weavers, carpenters, goldsmiths and others. Artisans were treated as village servants and there was absence of localization of industry. However, some kind of entrepreneurship existed among the artisans in cities on the banks of rivers, mostly because rivers provided transportation facilities. Indian artisanship was well recognized all over the world. For instance, *corahs* of Bengal, *dupattas* and *dhotis* of Ahmedabad, silk-bordered clothes of Nagpur, shawls of Kashmir, Amritsar and Ludhiana and brass, metal and copper wares of Banaras and Moradabad. Moreover, this India was well-known for artistic industries like marblework, stone-carving, jewellery, brass, copper and wood-carving. Manufacturing entrepreneurship did not develop in India till 1850 due to weak communication and transportation systems. In spite of such a discouraging environment for entrepreneurship, the export trade of textiles in the seventeenth century was ascending.

Entrepreneurial Growth after 1850

In the middle of the nineteenth century, the British considered exploiting the natural resources of India to their advantage. To penetrate the Indian territory, they undertook the building of certain infrastructure such as roads and railways.

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The 'Swadeshi' campaign which began in 1905 emphasized the use of indigenous goods. It was an important expression of nationalism and inculcated and developed a feeling of pride as Indians. Jameshedjee Tata also named his first mill Swadeshi Mills. The purpose of the Swadeshi movement was to encourage the Indian industries and to promote their interest.

After World War I, the Government of India agreed to provide 'discriminating' protection to certain industries, even requiring that companies receiving its benefits be registered in India with rupee capital and have a proportion of their directors as Indians. East India Company's arrival in India was the hidden consequence of manufacturing entrepreneurship.

Entrepreneurial Growth in the Post-Independence Era

The post-Independence era witnessed industrial development, innovations by individuals or corporations relating to a product, organization or market; rise and mobility of certain castes or communities in relation to business activities; and entry of venture capital in an altogether new line. After Independence, the Indian Government framed an industrial policy to set up production and combat inflationary tendencies.

The Industrial Financial Corporation of India (IFCI) was set up in 1948 to develop industry.

During the periods of the First and Second Five-Year Plans, major proposals for establishing basic industries were formulated under the government sector.

During the post-Independence era, the government has provided stimulation for the growth of the private sector, both small scale and large scale. Diversification of industry, generation of employment potential, policy of import substitution and export promotion, and use of new and advanced technologies have significantly changed the nature of Indian entrepreneurship and brought in new techniques of modern management. During this period, the existing large business houses have taken advantage of the extremely favourable atmosphere and diversified widely. A large number of established entrepreneurs have stepped into disparate industries to the extent that the textile mills have marched into the area of electronics. Family-held entrepreneur groups like Tata, Birla, Dalmia, Kirloskar and Bajaj have expanded their businesses. The government has established various entrepreneurship development institutes and strengthened the role that entrepreneurship plays in economic development.

There can be seen a different trend in entrepreneurship development in the globalization era. This has seen the rise of new breed of entrepreneurs like Aziz Premji, the Ambanis, Laxmi Mittal, Adi Godrej, Jindals, Hinduja brothers, Pallonji Mistry and many more. Two main time periods can be considered crucial here. The first being the IT boom of the 2000s which led to the growth of many fierce leaders in the IT sector and the resultant lucrative profile of India in the world IT service and the second being the recession in 2008 which has given a

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great push to the start-up culture. It has been considered that the start-up culture has just started and is only going to flourish. With the challenges of newer avenues of businesses given the rapid development of technology, there is going to be rise of newer leaders in the digital field.

Check Your Progress

1. What is the crux of entrepreneurship?
2. How is organization building skill a critical requirement for successful entrepreneurship?
3. Mention the eras into which the study of entrepreneurial growth in India has been divided.

1.4 ROLE OF ENTREPRENEURSHIP IN ECONOMIC DEVELOPMENT

According to Peter Drucker (1970), entrepreneurship deals with risk-taking. The behaviour of the entrepreneur is reflective of the type of individual prepared to stake his or her financial security as well as career in the name of an idea, and spend a lot of capital and time on uncertain ventures. Uncertainties have been classified by Drucker as follows:

- Risk that can be statistically measured (e.g., the probability that a blue pen will be drawn from a box which contains five blue and five black pens).
- Ambiguity, or that which cannot be easily measured in statistical terms (e.g., the probability that a blue pen will be drawn from a box which contains five blue pens, but an unknown number of black pens).
- True Uncertainty or Knightian Uncertainty, which cannot be estimated or statistically predicted (e.g., the probability that a blue pen will be drawn from a box which contains an unknown number of blue pens and other coloured pens). Drucker has also aptly observed that 'Innovation is the specific tool of entrepreneurs, the means by which they exploit change as an opportunity for a different business or a different service. It is capable of being presented as a discipline, capable of being learned and practiced. Entrepreneurs need to search purposefully for the sources of innovation, the changes and their symptoms that indicate opportunities for successful innovation. And they need to know and to apply the principles of successful innovation.'

Systematic innovation, according to him, has to do with searching for changes in an organized and purposeful manner and systematically analysing the opportunities offered by such changes in terms of social and economic innovation. This in turn leads to economic development.

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Entrepreneurship positively affects economic development. The following are some of the ways:

- By starting a new enterprise, entrepreneurs increase jobs in the market and thereby promote employment.
- Entrepreneurs are also looking for new avenues and many times start their initiatives in previously unexplored or less developed areas. Their venturing into these areas promote the ascent of supportive services and facilities, thereby boosting the local economy and regional development.
- When starting their ventures, entrepreneurs inject their fresh capital and resources, and aim for a viable company. This initiate attracts investors from varied range which assists people to create wealth by investing in new projects.
- Entrepreneurs are interested in innovating and bringing newer more advanced products to the market to not only create a unique market position but also increase customer satisfaction. Thereby, the upgraded and innovative products help raise the standard of living of people.
- Entrepreneurs are always on the lookout for expanding their successful business and once the local economy is explored, they naturally aim for a global footprint and this export angle not only attracts a lot of foreign capital but also promotes trade and the economy.
- Optimization of capital is also a key focus area for entrepreneur who aim at a good capital return ratio in terms of high output capital ratio and high employment capital ratio.
- Entrepreneurs undoubtedly begin their enterprise by mobilizing the local resources which has a positive influence in terms of efficient utilization of resources in the neighbourhood.
- While innovating for new products, entrepreneurs are also interested in meeting the actual demands of the customers, thereby maintaining the demand ratio and avoiding any shortage of supply.

1.5 AGENCIES IN ENTREPRENEURSHIP MANAGEMENT

Entrepreneurial talent can be nurtured by undertaking various Entrepreneurship Development Programmes (EDPs). 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.

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The basic objectives of EDPs are to:

1. Provide knowledge about the industry, product and production methods.
2. Develop and strengthen entrepreneurial qualities to achieve the objectives and goals of an enterprise.
3. Assist the entrepreneur to work more effectively in his present position by exposing him to the latest concept, techniques and information.
4. Analyse and acquire knowledge about the environmental factors that are required to set up a small scale industry in a specific region or area.
5. Provide education regarding customers' buying behaviour, customer relationship and customer service.
6. Provide knowledge about the available financial services and supporting agencies for starting a small scale industry.
7. Acquire necessary managerial skills needed to run the enterprise.
8. Help know the pros and cons of being an entrepreneur.
9. Guide entrepreneurial behaviour in day-to-day activities.
10. Prepare the entrepreneur for the uncertainties involved in business and to develop a broad vision about the business.

Organizations conducting EDP in India

Several organizations are conducting entrepreneurship development programmes in India.

The forerunner was the Small Industries Development Organization which provided this facility through its Small Industries Service Centres. The Entrepreneurship Development Institute of India (EDII) is an autonomous and not-for-profit institute set up in March 1983 at Ahmedabad. The mission of EDII as mentioned on their website is to: 'become a catalyst in facilitating emergence of competent first-generation entrepreneurs and transition of existing SMEs into growth-oriented enterprises through entrepreneurship education, training, research and institution building.'

In the same year, the central government also established the National Institute for Entrepreneurship and Small Business Development (NIESBUD) in New Delhi, with the objective of coordinating activities related to entrepreneurship and small business development. Both these organizations are working hand in hand to boost the entrepreneurship development movement in India.

Other institutions established by the government are: Rural Entrepreneurship Development Institute (RED) at Ranchi in 1983, Rural Management and Management Centers (RMEDC) at Maharashtra, and Training cum Development Centres (RDCS) that are intended to increase interaction between entrepreneurs and enterprise.

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Other organizations actively conducting entrepreneurship development programmes are the State Bank of India, Industrial Development Bank of India, Entrepreneurial Motivation Training Centre in the Northern-Eastern region, Xavier Institute of Social Services, Ranchi, Industrial Consultancy Organizations in various states, Centre for Entrepreneurship Development, Ahmedabad, the Centre for Entrepreneurship Development, Hubli, State Financial Corp, Small Industries Extension Training Institute, Hyderabad, National Science and Technology Entrepreneurship Development Board.

A Centre for Entrepreneurship Development (CED) was registered in Madhya Pradesh on 17 November 1988, and later taken up by IFCI. An institute for Entrepreneurship Development was also set up at Goa under DB on the same pattern as other IEDs. A proposal to set up an IED for the North-Eastern Region was also under consideration by the North Eastern Council. A few state governments such as those of Karnataka, Andhra Pradesh, and Rajasthan, have also put forward their proposals for setting up CEDs in their respective states. These are to be considered on their merits by the financial institutions. The focus of the national organizations such as EDII and NIESBUD was on (i) institutional entrepreneurship activities, (ii) generating, sharpening and sharing knowledge through research documentation and publication, (iii) creating and developing professionals in the discipline of 'entrepreneurship' to emerge and flourish, and (iv) developing new products and pursuing market segments for carrying the entrepreneurship development in priority areas and sections of the people.

Management Development Institute (MDI)

For developing and improving the quality of day-to-day management, which is crucial for the success of any industrial venture, as also, with a view to encouraging professionalism in management, IFCI had sponsored in 1973, the setting up of the Management Development Institute (MDI) at Gurgaon (Haryana) near New Delhi. MDI provides management training, research and consultancy, and its prime goal is to improve managerial effectiveness in the industry/government and banking' sectors of the economy. The organization's Annual Report of 2009 mentioned that MDI had been chosen by the Department of Personnel and Training, Government of India, as an agency for conducting the first, 15-month National Management Programme (NMP) for government officers belonging to IAS/Group 'A' Services as well as executives from public and private sector organizations who have the potential to acquire top positions. The MDI conducts management development programmes in various fields. These include programmes for officers of the Indian Economic Service (IES), Indian Administrative Service (IAS) and for executives of a number of PSUs such as Oil & Natural Gas Commission (ONGC), Bharat Heavy Electrical Ltd. (BHEL), Bharat Aluminium Co. Ltd (BALCO), Export Credit Guarantee Corporation of India (ECGC), Bureau of Indian Standards (BIS), Hindustan Zinc Ltd (HZL), Hindustan Machine Tools Ltd (HMT), Indian Drugs & Pharmaceuticals Ltd (IDPL), Uttar Pradesh State

Industrial Development Corporation Ltd (UPSIDC) and Madhya Pradesh Financial Corporation (MPFC).

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Entrepreneurship Development Institute of India (EDII)

Entrepreneurship Development Institute of India (EDII), the principal agency with special responsibility for entrepreneurship development in the country, has been focusing on creating curriculum for entrepreneurship development and innovative training techniques for trainers. The institute has developed an experimental EDP for women, keeping in view their special needs and the first such EDP was conducted in September 1988. Over the years, EDII has carried out experiments in rural entrepreneurship development in a cluster of villages of U.P. and Orissa in collaboration with a voluntary organization.

Science and Technology Entrepreneurship Parks (STEPs)

As part of the programme for supporting the setting up of fifteen STEPs jointly with other institutions, IDBI over the years has assisted seven STEPs viz., those sponsored by the Birla Institute of Technology (BIT), Ranchi, National Entrepreneurs Chemical Park (NECP), Regional Engineering College (TREC), Trichy, Harcourt Butler Technological Institute (HBTI), Kanpur, Sri Jayachamarajendra College of Engineering (SJCE), Mysore, Guru Nanak Engineering College, Ludhiana and Maulana Azad College of Technology, Bhopal with the aggregate assistance of ₹6.2 crore.

BIT-STEP has developed a unique technology for automatic wire length measurement system and import substitutive stainless steel wedge wire screen, besides other technologies for industrial applications. NECP-STEP is engaged in the preparation of project profiles of selected imported drugs. TREC-STEP has developed technology for hi-tech paints for nuclear applications, besides other hi-tech and import-substitutive products. Seven TREC-STEPS entrepreneurs have already started commercial production. Student entrepreneurs of HBTI-STEP are working on projects which include fibre reinforced concrete and plastic components. SJCE–STEP has transferred technology of liquid level pump controller to one of its entrepreneurs for commercial exploitation and eight STEP entrepreneurs have established their units.

Institute for Entrepreneurship Development (IED)

Institute for Entrepreneurship Development was established as part of a strategy of giving special attention to entrepreneurship development needs of the more backward states. IDBI had proposed to set up Institutes for Entrepreneurship Development (IEDs) in association with other financial institutions and banks and state governments. IEDs that were set up in Uttar Pradesh, Bihar and Orissa have become operational and the proposed IED in Madhya Pradesh has been registered.

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The Centre for Entrepreneurship Development (CED)

The Centre for Entrepreneurship Development (CED), Ahmedabad, was sponsored by the state government and public sector corporations concerned with industrial development in the state. This centre conducts entrepreneurship development programmes. The success rate of CED programmes is reported to be 66 per cent.

The Entrepreneurial Motivation Centre

The Entrepreneurial Motivation Centre was set up in Assam in the north-eastern region of India to conduct entrepreneurial development programmes. In the initial period, 28 officers drawn from various departments of the state government were given training in entrepreneurial motivation, economic investigation and survey, management of small enterprise, etc. at the Small Industries Extension Training Institute in Hyderabad. These officers then joined the various branches of the Entrepreneurial Motivation Training Centre in six districts. The Entrepreneurial Motivation Training Centre gave wide publicity to the entrepreneurial development programmes and invited applications from educated unemployed persons.

The National Institute for Entrepreneurship and Small Business Development (NIESBUD)

The New Delhi-based National Institute for Entrepreneurship and Small Business Development (NIESBUD), established by the Government of India, is an apex body for coordinating and overseeing the activities of various institutions and agencies engaged in entrepreneurship development particularly in the area of small industry and small business. The institute is also the secretariat of the National Entrepreneurship Development Board (NEDB), the apex body which determines policy for entrepreneurship development in the country.

The activities of the NIESBUD include:

- evolving effective training strategies and methodology
- standardizing model syllabi for training various target groups
- formulating scientific selection procedures
- developing training aids, manuals and tools
- facilitating and supporting central/state/other agencies in executing entrepreneurship development programmes
- maximizing the benefits and accelerating the process of entrepreneurship development.

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.

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The objectives of the schemes are:

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

There are also certain other agencies for entrepreneurship development including Small Industries Service Institute, Institute for Rural Management and Administration, Small Industries Extension Training Institute, Small Industries Development Organization, National Small Industries Corporation, etc. These will be discussed in further units.

1.5.1 Future of Entrepreneurship

The history of Indian entrepreneurship is full of paradoxes ranging from heights of glory as pioneers of sea trading to the abyss of colonial freeze under British rule. Despite all odds, the fire was never extinguished from the natural genes of the Indian entrepreneur who survived to reappear whenever history accorded the opportunity. Today, Indian entrepreneurs are among the most successful and respected across the globe for their grit and acumen.

Indian entrepreneurship is well on its path of global domination and holds the promise to aid the national economy in terms of providing employment and bringing about development in rural areas. The changed and charged environment of entrepreneurship in the country motivates many brilliant young people to opt away from fat salaries in MNCs and work in their own ventures.

Successful entrepreneurs such as Azim Premji, Narayana Murthy and Dhirubhai Ambani have inspired a whole new generation to look forward into the future with unbound hope even if they don't have influence or inheritance to back them. The Indian entrepreneur is all set to achieve new heights of success and growth in the years to come.

India is slowly becoming one of the biggest and attractive markets in the world, both for foreign companies to invest in and the local startups to gain market share. This is a combined result of a number of factors including but not limited to the demographic, skills and the benefits of the IT boom of the early 2000s. Besides a number of government initiatives are also promoting entrepreneurship in India with schemes like Startup India, Make in India, among others. As per a Nasscom-Zinnov report of 2018, India is the third largest eco-system of startups in the world with close to 7200-7700 startups. Further, India has now a total of 18 unicorn startups!

A report by the Department of Industrial Policy and Promotion (2018), suggests that around 14,565 startups were registered in the year. The future does look promising but for it to become a reality, there is a need to tackle three important areas of crony capitalism, cumbersome licensing legislations and problems of inequality.

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Check Your Progress

4. What does entrepreneurship deal with in terms of risk as per Peter Drucker?
5. Define EDP.
6. Name the apex body which determines policy for entrepreneurship development in the country.

1.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Entrepreneurship transforms ideas into economic opportunities. That is the crux of entrepreneurship.
2. 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.
3. The study of entrepreneurial growth in India has been divided into three eras, viz, entrepreneurial growth before 1850, from 1850 till independence, and post-independence.
4. As per Peter Drucker, entrepreneurship deals with risk-taking.
5. EDP refers to Entrepreneurship Development Programmes which are programmes designed to help an individual strengthen his entrepreneurial motive and to acquire skills and capabilities so that he can play his entrepreneurial role effectively.
6. The apex body which determines policy for entrepreneurship development in the country is National Entrepreneurship Development Board (NEDB).

1.7 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 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.

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- Entrepreneurship = Entrepreneur + Enterprise
- From the economic standpoint, initially the economists used to discus 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'.
- 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.
- Entrepreneurial growth in any country must evolve within the context of the economic history of that particular country. The study of entrepreneurial growth in India has been divided into three eras, viz, entrepreneurial growth before 1850, from 1850 till Independence, and post Independence.
- Entrepreneurial talent can be nurtured by undertaking various Entrepreneurship Development Programmes (EDPs). 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.

1.8 KEY WORDS

- **Entrepreneur:** The creator and maintainer of an enterprise
- **Entrepreneurship:** The concept where a person organizes his own business and runs it profitably exploiting the qualities of leadership, decision making, managerial calibre, etc
- **Gestation period:** Represents the time gap between registration and commencement of commercial production

1.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What is the importance of entrepreneurship?
2. What is the difference between entrepreneur and entrepreneurship?

3. List the objectives of Entrepreneurship development programmes.
4. What is the role of entrepreneurship?
5. Write a short note on the future of entrepreneurship in India.

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Long-Answer Questions

1. Discuss the nature of entrepreneurship.
2. Describe the history of entrepreneurship management in India.
3. Discuss the agencies promoting entrepreneurship in India.

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UNIT 2 THE ENTREPRENEUR

NOTES

Structure

2.0 INTRODUCTION

In the previous unit, you studied about the meaning and concepts of entrepreneurship, history of entrepreneurship development and the role of entrepreneurship in economic development.

An entrepreneur is always viewed as a risk-taker and innovator. An entrepreneur is someone who gives shape to a business innovation, which is a risky financial preposition. Despite risk, he does so because that excites him.

In this unit, you will study about the qualities of a successful entrepreneur, skills required for an entrepreneur, the entrepreneurial decision-making process, and some role models for an entrepreneur.

2.1 OBJECTIVES

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

- Explain the meaning of an entrepreneur
- Identify the qualities that one should possess for being a successful entrepreneur
- Assess the skills that an entrepreneur should possess
- Define the steps in the entrepreneurial decision process
- Describe the influence of a role model, mentor and the support system on an entrepreneur

2.2 ENTREPRENEUR: MEANING AND CONCEPTS

The Merriam Webster Dictionary defines an entrepreneur as 'one who organizes, manages, and assumes the risks of a business or enterprise'.

Wikipedia.com defines an entrepreneur as 'one who undertakes innovations, finance and business acumen in an effort to transform innovations into economic goods'.

Kuratko, D. F and Hodgetts, R.M. (2001) defines, 'An entrepreneur is an individual who efficiently and effectively combines the four factors of production. Those factors are land (natural resources), labour (human input into production using available resources), capital (any type of equipment used in production, i.e. machinery) and enterprise (intelligence, knowledge, and creativity.)'

William B. Gartner (1988) defines an entrepreneur who is involved in 'the creation of new organizations'.

Thus, many dimensions of entrepreneur are addressed in every definition.

William D. Graves (1994) gave 'The Ten D's' of an Entrepreneurs' to define entrepreneur:

1. **Dream:** vision and ability to implement it
2. **Decisiveness:** swiftness in decision-making
3. **Doers:** believe in doing things
4. **Determination:** seldom give up
5. **Dedication:** so much that often that affects their relationship with friends and family
6. **Devotion:** love what they do
7. **Details:** do not leave details unattended
8. **Destiny:** they make their own destiny, they believe strongly
9. **Dollars:** money is not the main driver, it is just a measure of success
10. **Distribute:** believe in distributing ownership with key employees critical for the success

Meaning of the term entrepreneur must be clear from the above definitions and explanations. An entrepreneur not only generates self-employment, but also brings pride for himself in addition to bringing national pride. Entrepreneurs fill the supply-demand gap and also create demand. Entrepreneur thus, means a vibrant person who has a strong sensory system for sensing existing opportunities or creating new opportunities, and converting them into a meaningful business that generates economic and social good for the mankind.

2.2.1 Qualities of a Successful Entrepreneur

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Often entrepreneurs see things differently, think differently and want to do something different. We will list qualities of entrepreneur that some authors have prepared and then discuss those qualities. We have retained the list as given by the authors concerned, though at some places skills are also included in characteristics.

Schumpeter (1934) discovered that entrepreneurs:

- greatly value self-reliance
- strive for distinction through excellence
- are highly optimistic (otherwise nothing would be undertaken) and
- always favour challenges of medium risk (neither too easy, nor ruinous)

Baruah, Achintya Kr. concluded that the characteristics of a unique entrepreneur are as follows:

(i) Need for achievement
(ii) High need for power
(iii) Independence
(iv) Propensity to take risk
(v) Personal modernity
(vi) Support
(vii) Business enterprise
(viii) Leadership

Characteristics of an Entrepreneur

Many authors and researchers have written about the different characteristics of an entrepreneur. The following it as inspired by writer Don Hofstrand.

(i) Risk-taking

What do we mean by 'risk-taking' characteristic of entrepreneurs? In fact, it would be inappropriate to say that entrepreneurs are risk-takers. Risk-taking in its true sense indicates that risk is ignored in taking decisions and actions. We should rightfully use the word 'risk averse' for the entrepreneurs. Risk averseness implies taking 'calculated' risk and expecting premium for the risk taken. As the risk goes up the expected premium in return also goes up at a higher rate.

Calculated risk means a few things, namely,

(a) Determining how much risk one should take. Risk taking ability of a rich person is higher than that of a poor person. Still, two equally rich persons in equal situations may not equally perceive the risk in a given opportunity.
(b) Risk assessment is equally important.

(c) Risk mitigation is the final step that a risk-averse person would consider while taking calculated risk. Risk mitigation means taking steps to manage risk. For example, insurance against non-business is essential; identify non-business risks and insure them.

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(ii) Sense of limits

In every society people develop sense of limits from parents, friends and surroundings. These are the limits of what we can do and what we cannot, and what we can accomplish and what we cannot. Such sense of limit is a result of social permissiveness at a given point of time in a society. On one side, developing such sense of limit is desirable because without adhering to social norms a society cannot function as a civilized society. On the other, the same sense of limit would impose more 'don'ts' than 'dos'. Entrepreneurs are different. Many of them do not abide by the limits recognized by the society or they fight against these limits.

(iii) Locus of control

There are two types of people in the world– those who blame others and external situations for whatever happens with them, and those who believe that they could have done something better to avoid certain situations that happened with them. The first type of behaviour of people is called 'external locus of control' and the second 'internal locus of control'.

It is obvious from the definition that entrepreneurs have 'internal locus of control'. The sense of internal locus of control gives tremendous strength to entrepreneurs for positive thinking and perseverance. It also gives energy to learn from failures rather than accepting fate.

(iv) Control of future

Entrepreneurs are always in control of the situation. Their responses to the unfolding situations are more matured rather than like reactions. This gives them control over the current period as well as the future.

(v) Creators

Entrepreneurs create ideas, businesses and organizations. Often they like businesses that are unique compared to the routine ones. They like challenges and deal with them in a unique or creative way. Entrepreneurs are good at start-ups.

(vi) Need for achievement

Entrepreneurs do not start business for making money. Money and profits are not his primary goals. Their passion, thus, is to convert their dreams into reality.

(vii) Ethics

Can anything substitute ethics for a successful person? Can an entrepreneur be unethical and still make long-term success and attain his need for attainment? A true entrepreneur, since he is not driven by motives of profits but needs to achieve or do something different for getting sense of satisfaction, will demonstrate high

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degree of business ethics. Ethical game is necessary for a long-term player in the business of innovation.

An entrepreneur is a thinker and innovator who also converts ideas and opportunities into a business preposition and continuously own all the activities involved in this cycle. His visionary character, risk-taking nature, ability to remain focussed, willingness to learn from setbacks and failures, persistence and perseverance, relentless exploration, strong belief that he can bring funds and collect all resources, confidence to manage resources, ability to manage odds, building teams, confidence to make things happen and team-building are essential characteristics that brings success for him/her.

2.3.2 Personality Types of Entrepreneurs

Zahorsky mentioned nine types of personalities of entrepreneurs, which is based on 9-point circle of Enneagram. They are given as under:

(i) **The improver:** An improver operates business with high degree of integrity and ethics and focus on continuous improvement.

(ii) **The advisor:** An advisor entrepreneur tends to be focussed on customer needs, and they provide high level of assistance and advice to customers.

(iii) **The superstar:** Charismatic entrepreneur is a superstar. Business is centred around the superstar who is very competitive in nature.

(iv) **The artist:** An entrepreneur is reserved but creative in nature, like an artist. Creativity based businesses succeed with this type of entrepreneurs.

(v) **The visionary:** Some entrepreneurs are completely driven by their own vision and values. They have curiosity to understand and improve the world around them.

(vi) **The analyst:** Some have tendency of investing their time in fixing problems in a methodical way. Where problems are of structured nature like that in science, engineering and software development this type of entrepreneurs succeed well.

(vii) **The fireball:** An entrepreneur who brings energy, optimism and life in the environment is called the fireball. These people set higher goals and achieve them, but are often impulsive.

(viii) **The hero:** When will and ability to lead is so strong that a person can take the business through any challenge, it is the hero type personality of an entrepreneur.

(ix) **The healer:** An entrepreneur who has the ability to nurture and develop people, who usually have inner calm, bring harmony in the organization and act as healer.

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Check Your Progress

1. Define risk averseness.
2. Which type of locus of control do entrepreneurs have?
3. What is necessary for a long-term player in the business of innovation?
4. Which type of an entrepreneur are called the healer?

2.3 SKILLS REQUIRED FOR AN ENTREPRENEUR

In addition to possessing personal traits, an entrepreneur must also have certain skills without which he cannot succeed. Only when personal traits and skills combine a real entrepreneur emerges. Some most important skills that an entrepreneur must possess are briefly described hereunder.

1. Leadership and Motivation Skills

Success is more attributed to the leadership skills. In fact, all the skills required of an entrepreneur to succeed would be encompassed in the leadership skills. However, under this heading we have included some of them and the rest are listed separately.

- **Visualization skills:** Visualization does not mean innovation, but visualizing practical relevance of innovation if innovations are carried through the process leading to conversion into business operations. An entrepreneur who has an idea should have the skills of visualizing the entire process and tasks that can convert an idea into a real tangible business.
- **Goal-setting skills:** It is not easy to set goals for even routine tasks like budgeting and sales. For routine tasks, previous period data is available, which when plotted on a time-line one would get a pattern. This pattern can be interrupted with intervention through promotion policies, quality, pricing, distribution channel and many decision variables that a company may use. However, in case of a new idea neither historical data is available nor there is any experience about the variables that are critical for converting awareness into a demand for product and services.
- **Ability to guide:** An entrepreneur's ability to guide key employees towards attainment of goals assumes great significance. Continuous dialogue and addressing doubts and queries on routine basis before they become concerns, willingness to make adjustments in goals as more information unfolds and having earned respect and trust are the key elements in ensuring that an entrepreneur is able to guide the employees.
- **Motivation skills:** Motivation skill is a higher level skill than guiding skills. There is always a possibility that an averagely capable person can perform

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well if appropriately motivated. An entrepreneur should not only make adequate payment but also be ready to provide recognition for good work, be available for counselling, and be available for listening to views and even personal problems. These are some of the tools for motivation, but motivation is more about skills, which involves identification of demotivated people, understanding factors for demotivation and selecting appropriate way of motivating the person concerned.

- **Ability to organize:** Identifying manpower requirement with right knowledge, skills and attitude is a challenge for an entrepreneur. Head-hunters may only help you to connect, but assessment about appropriate fit in terms of all three criteria (knowledge, skills and attitude), is a critical function that an entrepreneur has to perform. The entrepreneur has to visualize a structure of organization and fill it with the right policies, procedures and documentations so that the tasks get organized in an effective manner.
- **Team player:** An entrepreneur, who is a team leader, must possess team skills. In fact, he must have the ability to work in a team as well as individually. Team skill is stronger among those who have their studied and candid opinion on issues and problems, they have listening skills, they have openness to accept new arguments and reshape their thoughts at the decision-making stage. At the execution stage, those who are team players keep constant communication with those for whom this task matters. Hence, coordination will be strong and people will see his task and activities in the context of totality. A true team player gives benefit of doubt to others and respects others for their opinion and abilities.

2. Communication Skill

Communication skill comprises listening skill, skill to comprehend, skill to contextualize, and skills to articulate in a coherent manner. An entrepreneur must develop these skills. Careful listening not only gives several new ideas and puts ideas in the right context, but also acts as a motivation to others and encourages others to align their interest with that of the organization, because it develops the sense of recognition.

3. Negotiation Skill

Communication skills help in negotiations with vendors, contractors and potential customers. Negotiation skills also involves knowing the opponent's strength and weaknesses, determining what to tell and what not, judging when to bring divergence in discussion and when to break, intelligently determining with whom to negotiate and when and where to negotiate and so many other strategic issues. Good negotiation would result in a win-win situation for both the sides and one who demonstrates better negotiating skills will benefit the most.

4. Creative and Critical Thinking Skill

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Entrepreneurs are creators. Creating a new idea is one thing and creative thinking needed for problem solving and in recognizing opportunities is another. One should possess creative thinking and a realistic approach. This also requires critical thinking: Why this and why not something else? why this way and why not in a different way? This kind of inquistive mind indicates the critical thinking ability. This indicates search for efficiency and improvement.

5. Decision-making Skill

Life is about choices and decisions. For a start-up there are several instances where critical decisions have to be taken and each decision has an impact on success or otherwise. Problem identification is a skill. Steps like determining what is the right time for solving the problem, analysing it, exploring an alternative solution and evaluating them in terms of short-term and long-term impact and getting the decision executed may look simple but involve demonstration of a deeper skill level.

6. Multi-tasking and Time Management Skill

Before the start-up sees the light of the day, and even after, an entrepreneur may have to work on several fronts. He does not have manpower available at the pre-start-up stage. The start-up stage is a trying stage where multi-tasking skills of an entrepreneur are tested by the people whom he approaches. It involves not just selling an idea of a new venture but also dealing with many venture capitalists for funding, lawyers for formation of business, getting copyright or patent, exploring clientele, discussing with potential suppliers, and so many others. Need for multi-tasking, therefore, tests an entrepreneur's time management skills which essentially involves prioritization of tasks, and persuasion of important tasks while doing urgent tasks.

7. Networking Skill

Good ideas alone do not fetch friends. One has to depend on networking. Networks allow others to interact with others and vice-versa. Networking is a double-edged tool. Networking gives you an advantage when you decide with whom to do business and with whom not to. At the same time it may work against you if you do not know how to present yourself in the network, because others also would see through you. Your substance, truthfulness and trustworthiness are very important in building credibility among other network members.

8. Practical Skill

Practical skill is not about *jugadu* skills. *Jugadu* skills are often understood in the context of bending rules and 'somehow' getting the work done. It implies improper and unethical approach, which are not desirable from an entrepreneur. One may adhere to the principles and values and still be practical. Practical skills here mean lack of rigidity. It is about understanding others and their positions, and dealing with them diplomatically without compromising on values. Practical skills often include being able to plan and execute things.

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Check Your Progress

5. What does the skill of ability to guide entail for entrepreneurs?
6. List the constituents of communication skill.

2.4 THE ENTREPRENEURIAL DECISION PROCESS

Many tough decisions are involved in the entrepreneurial decisions. Some entrepreneurial decisions are because of feeling that one is not recognized or rewarded appropriately on the job place. In some other cases frequently losing jobs make a person to think of becoming boss of oneself. In some cases, when a family moves from one place to another, the need for pursuing economic activity or keeping oneself active and busy, a thought of starting a business may result into new entrepreneurship.

2.4.1 Entry Decision

Whether to start a new business or not is the most critical decision. The significance of entry decision would be clear from the following points:

(i) **Change in lifestyle:** Decision to become an entrepreneur would suddenly change one's lifestyle. It may mean more working hours, no holiday, uncertainty around everything that one is trying to do for starting a new business, loss of cash flow for family and responsibility for one's own decision. Initial enthusiasm is a driving force in tackling issues surrounding change in lifestyle. But when the reality is faced (no time for family and for socialization, business outcome is not as per expectations, work getting delayed, among others) enthusiasm is likely to fade.

(ii) **Loss of financial security:** An entrepreneur foregoes the chance of a fixed and secured cash flow in pursuit of entrepreneurship. If financial security is not ensured, then one can imagine the mental stress that the entrepreneur and his family will go through. It is, therefore, very important to ensure that before embarking on entrepreneurship one has made assessment that the family will be able to continue with the same lifestyle as before and all financial commitments of near future would be met. Future financial commitment means if a child is going to college, one should have enough money to finance the education.

(iii) **Change in social equations:** Social engagement is likely to take a nosedive and new social equations would be formed. This is true for family members of the new entrepreneurs too. Initially, current social group would perhaps

NOTES

look at the new initiative with admiration, but with declining engagement of the entrepreneur in the society the relationship may take turn, if not with all, at least with some.

Networking requirement of an entrepreneur will lead to formation of new social groups, but these new groups will be for some common purpose (therefore, it can be called networks or professional groups rather than social groups) and just for break from routine. Network groups do not meet in informal and free environment and, therefore, those engagements are not free from tensions.

(iv) **Daily uncertainty:** Before the business is set up there are moment to moment uncertainties. Simple and easy tasks take time and often encounter unexpected hurdles. Conflict with principles and value system is also a routine experience. These uncertainties cause stress and may lead to demotivation. Even after the business is set-up, uncertainties remain away. Finding sources of supply, recruiting the right people, getting market, operations difficulties, and such other area become uncertain, more so in the initial phase. Once the operations become routine, the familiarity with business variables improve and uncertainties reduce.

2.4.2 Business Decisions

Once the first decision to make entry in entrepreneurship arena is taken the immediate next set of decisions can be grouped as 'business decisions'. First among them is preparation of business plan, then exploring funding options, deciding on the form of business organization and actually forming the organization, nurturing initial phase of business, managing routine operations and managing growth are the broad areas of decision one has to take as a part of business.

(i) **Business plan:** Preparation of a business plan is the first step toward becoming an entrepreneur. The idea and its feasibility are documented in a business plan. Technical feasibility, market feasibility and financial feasibility of the idea are studied and result of the study is presented in a good business plan.

(ii) **Raising funds:** A good business plan will draw attention of funding agencies and create positivity among them. Potential equity participants assess the potential growth and value of the business to make extraordinary gains. In the market there are players like venture capitalists and angel investors who are ready for equity participation in a risky business.

(iii) **Form of business organization:** Selection of form of business organization is the most important decision at this stage. Sole-proprietorship form is possible for those who want to go alone as owner. If friends, siblings, cousins, venture capitalist, angel funds or any others are partners then one has to consider any type of partnership firm or a private company or a public company.

(iv) **Nurturing business:** Nurturing a business is a challenging task. Based on clear vision one has to take several decisions and relentlessly keep exploring all options for developing a business. Funds are lined up, firm is formed (and registered, where registration is required), terms and conditions with funding agencies and registration document are clearly defined. The real challenge is recruiting competent people and assigning them the right tasks. Sharing vision and values with all important employees through various ways is also a conscious decision.

Another big challenge is creating a customer base. Innovation-based entrepreneurs, who create demand rather than filling a positive demand-supply gap, face this challenge, which they need to tackle carefully and with patience explaining benefits of new products and services to probable customers. Identification of probable customers (market segment) and approaching them requires skills, careful analysis, presentation skills, negotiation skills and several other skills.

In short, every business decision, when business is new, is challenging and requires many creative and timely decisions.

(v) **Managing operations:** Managing business, when it becomes matured after take-off, is another game. An entrepreneur is more of a manager than an entrepreneur when running routine business operations. An entrepreneur should start focusing on strategic matters now and delegate routine matters of business to professional managers employed by him.

(vi) **Managing Growth:** As we mentioned in the previous point, an entrepreneur would focus on strategic growth areas once the business has become routine and is on the auto-mode. Creativity and habit of diligence blended with application of growth models are key areas for successfully managing growth.

2.4.3 Exit Decision

Timely exit from business is required if business has failed, and it is desirable even when business has been launched well. Entrepreneurs who are creative and innovative would stop deriving satisfaction of creation and success once the business starts doing well. Selling business at that time is not only most profitable but also gives an entrepreneur a chance to venture into another enterprise.

2.4.4 Process of Decision-Making

Every decision goes through some steps, whether they are related to setting up of a new business or running it or even managing life. The followings are the steps in the decision-making process:

(i) **Clear objective:** Clarity about objective is essential in the backdrop of taking decision. Without clarity decision might be directed towards something that later on cannot be justified.

NOTES

(ii) **Defining problem:** Reaching to the root of the problem is important. Often symptoms are misunderstood as the problem. It is better to initially understand the problem rather than straight attempting to solve a visible problem. Lack of identification of any problem results in the loss of opportunities that may not even be noticed until it is too late.

(iii) **Developing alternatives:** Existence of problem itself proves that there must be alternatives. There is always more than one solution including 'do not do anything'. This takes care of two things; firstly, timing of decision and secondly, necessity of decision. There could be many alternatives. For example, a problem of lack of competitiveness could be due to the poor quality of the product or the high price of the product or ineffectiveness in distribution, or even the business model itself among others. High cost of product could be a result of inferior technology, poor workmanship, and insufficient process control, among others. Poor workmanship could be due to the absence of safety measures, lack of training and low employee morale among others.

(iv) **Identifying variables relevant to making decision:** Each alternative solution will have different impact on business in terms of cost and benefit. These costs and benefits are of three types:

(a) Qualitative

(b) Quantitative but not monetary

(c) Monetary.

Knowing everything needed for taking decision is useful, even if some data may not be available. The need of information is known, but no data is available from known sources. This happens in case of launching a new product in the market.

(v) **Collecting data:** Data collection is an important step from the viewpoint of: (a) speed of data collection, (b) quality of data, and (c) cost of data. Timely collection of most valuable and reliable data at the minimum cost could be the most rhetoric expectation. Time is the most important factor in long-term decision of strategic importance. Replacement decision therefore, may hardly be viewed as very important. Secondary sources of data save time but reduce reliability. Primary sources not only are expensive but time-consuming also.

(vi) **Analysis of data:** Data analysis is an art of juxtapositioning useful data to make sense out of it. Often use of charts, tables and diagrams and application of analytical tools will be useful in understanding collected data.

(vii) **Evaluation of options:** Many tools and techniques may be available to evaluate whether the initial goal can be attained, and up to what extent. Application of the right technique will give positive guidance and selection of wrong technique may not help in attaining the goal.

(viii) **Taking decisions:** The result of application of an evaluation technique can be accepted as a 'decision' if there is one and only one goal. There are many unknown factors and many non-quantifiable factors, which do not appear in the financial test. They have to be weighed separately against the primary goal. A decision maker is supposed to use the result of evaluation as guideline only. The decision should be taken only after due consideration of primary and secondary variables and after recognizing constraints.

Remember there is nothing like best decision that can give the predictable successful results. Every decision has some odds of yielding poor results.

2.4.5 Role Models, Mentors and Support System

Hereunder we will give some description of role models, mentors and support system.

Role models

Most entrepreneurs have some or the other role model, who inspire them. This inspiration may be explicit recognition of inspiration or it can be implicit. If an entrepreneur has a role model, he should study the role model's history, especially his failures, the characteristics needed to succeed, his style and competencies.

Mentors

Mentors are experienced entrepreneurs and experts in different fields. In the first stage, when the idea is thought of, discussions with some mentors will help in sharpening the idea and may sometimes assist in reshaping an idea completely. At the designing stage, in addition to offering ideas, mentors can use their network to provide a list of names that can help and also give positive references. Mentor's guidance in the market analysis stage will help in terms of making correct inquiry, getting correct data, and applying correct data analysis before any conclusion is drawn.

Support system

Entrepreneurs need support at the initial and the various stages of entrepreneurship. The most important support comes from spouse, family members, friends and neighbours. Social groups also come handy for solace, support and advice that an entrepreneur would need from time to time while sailing in the strange terrain of entrepreneurship. If the product or service is based on any technology, then professional groups would also be needed.

There are several examples of entrepreneurs who are role models for people all over the world. This also includes entrepreneurs who have become successful after facing multiple failures. Some examples of inspiring entrepreneurs include Ingvar Kamprad of IKEA, Henry ford of Ford Motors, Ray Kroc of McDonald's, Richard Branson of Virgin Group among others.

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Check Your Progress

7. In the process of raising funds, name two sources who are ready for equity participation in a risky business.
8. Mention the time when selling business is not only most profitable but also gives an entrepreneur a chance to venture into another enterprise.
9. What are the types of costs and benefits which impacts businesses when identifying variables?

2.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Risk averseness implies taking 'calculated' risk and expecting premium for the risk taken.
2. Entrepreneurs have internal locus of control. The sense of internal locus of control gives tremendous strength to entrepreneurs for positive thinking and perseverance. It also gives energy to learn from failures rather than accepting fate.
3. Ethical game is necessary for a long-term player in the business of innovation.
4. An entrepreneur who has the ability to nurture and develop people, who usually have inner calm, bring harmony in the organization are called ‘the healer’.
5. The skill of ability to guide entail the following for entrepreneurs: continuous dialogue and addressing doubts and queries on routine basis before they become concerns, willingness to make adjustments in goals as more information unfolds and having earned respect and trust.
6. Communication skill comprises listening skill, skill to comprehend, skill to contextualize and skills to articulate in a coherent manner.
7. In the process of raising funds, players like venture capitalists and angel investors are ready for equity participation in a risky business.
8. Entrepreneurs who are creative and innovative will stop deriving satisfaction of creation and success once the business starts doing well. Selling business at that time is not only most profitable but also gives an entrepreneur a chance to venture into another enterprise.
9. The types of costs and benefits which impacts businesses when identifying variables are: (a) qualitative, (b) quantitative but not monetary and (c) monetary.

2.6 SUMMARY

- The characteristics and skills of entrepreneurs get revealed from the list and quotations of successful entrepreneurs who failed many times before becoming famous.
- Ability to lead and motivate people, good listening and communication skills, good at negotiations, creative and critical thinking skills, among others are needed to be a successful entrepreneur.
- An entrepreneur has to take several decisions through the journey. Entry and exit decisions are the most important among all.
- Whatever the decision situation, the steps involved in decision-making are same, but degree of intensity would depend on the complexity of the problem.
- As an advice to budding entrepreneur one can say that look at your role model, find mentors that you need at various stages of entrepreneurship and solicit support from family, friends and neighbours, professional groups and other agencies that exist in the system.

2.7 KEY WORDS

- **Control of future:** Those who have control over situations have control over future.
- **Locus of control:** A feeling and attitude for blaming either others or taking responsibility for happening is called locus of control.
- **Multi-tasking:** This is an ability to attend to more than one task at the same time with all attentions needed.
- **Sense of limit:** The sense that what can be done and what cannot be, or how to behave and how not to, is called sense of limit, which is imbibed by

2.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What is the difference between entrepreneur and entrepreneurship?
2. Mention the loss of financial security in relation with entrepreneurship decisions.
3. Write a short note on the role models, mentors and support system required for an entrepreneur.

Long-Answer Questions

1. Describe the characteristics of an entrepreneur.
2. Identify some of the well known personality types of entrepreneurs.
3. Explain the entrepreneurial decision process.

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2.9 FURTHER READINGS

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UNIT 3 BUSINESS OPPORTUNITY IDENTIFICATION

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Structure

3.0 INTRODUCTION

In the previous unit, you studied about the qualities and skills required for a successful entrepreneur. The unit also gave a detailed account of the entrepreneurial decision-making process and the role models, mentors and support system required for an entrepreneur.

Strategic plans of a company lay out a canvas in which entrepreneur and employees of the company can see or visualize the ideas and opportunities that fit well and create synergy with the existing business of the company. Strategic plans set clearly defined goals on a timeline. Strategic plans also identify the best way of doing business (strategic thrust areas) for the plan period and expect everything that the company would do to follow those thrust areas. Strategic plans, therefore, not only guide the line of creativity but also set healthy rules for negotiation and allocation of capital budget on competing projects. Strategic plans must get the support of leadership and an organizational structure appropriate with the age and the size of the organization. The leadership must create an environment conducive to creative thinking, openness, less paperwork, higher level of efficiency and good intentions.

Separate systems for supporting generation and capturing of ideas must be created. These systems can be a combination of several formal, semi-formal and informal systems. Finally, projects are classified on various bases before the project organization is spelt out so that the stated objectives are attained. A company with a well-designed system for idea generation and processing, guided by clearly defined corporate philosophy and supported by well-designed strategic plans, leadership

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style and organizational structure is better poised to sail through fierce competition with success.

In this unit, you will learn about the various concepts related to generation and screening of project ideas. We will also discuss the administrative aspects as well as system aspects associated with the stages of capital budgeting.

3.1 OBJECTIVES

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

- Identify business ideas
- Describe the methods of generating idea
- Analyse business opportunities

3.2 BUSINESS IDEAS

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

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3.2.1 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.

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Check Your Progress

1. What are entrepreneurial projects an outcome of?
2. Name some of the sources who get huge opportunities from government investment plans.

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

(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?

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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

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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.

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.

Check Your Progress

3. What is known as the judgemental process of generating ideas?
4. Who do not give any service in the brain-storming dialogue?
5. In which type of an organization is shared vision a critical issue?

3.4 OPPORTUNITY RECOGNITION

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 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.

3.4.1 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 3.1.

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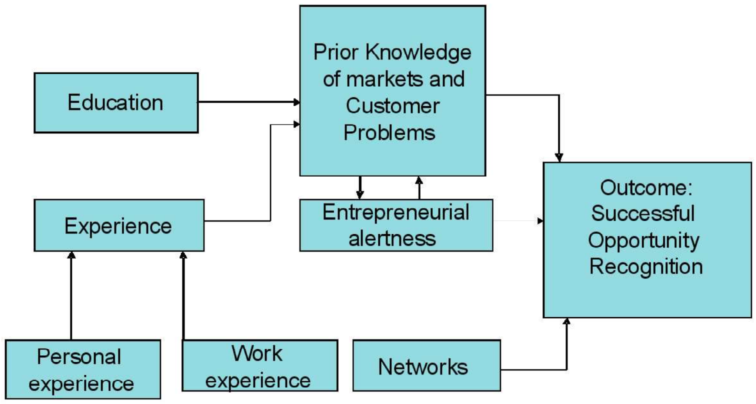

Fig 3.1 *Model of Opportunity Recognition Process*

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 3.1 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

(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.

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

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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.

3.4.2 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

6. Which elements are known as the moral commitments of a business?
7. State the aim of strategic planning.
8. What acts as a filter on acceptable opportunities?

3.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. 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.
2. Private contractors, fabricators, suppliers and service providers get huge opportunities from government investment plans.
3. Brainstorming is known as the judgemental process of generating ideas.
4. Whistle-blowers do not give any service in the brain-storming dialogue.
5. Shared vision is a critical issue in a large organization and not in a smaller one.
6. Mission and philosophy are the elements which are known as the moral commitments of a business.
7. 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.
8. Corporate philosophy acts as a filter on acceptable opportunities.

3.6 SUMMARY

- Some entrepreneurs, as a result of their curiosity and inquisitiveness, and relentless efforts, innovate new things. Some sense opportunities around new innovations and create an echo-system around that. Many businesses demonstrate entrepreneurial skills by being innovative in steering the business in new ways and in new directions. They sense opportunities through study of demand-supply gap, changing consumer taste, government policies and programmes, and by doing problem inventory analysis. The opportunities sensed by an entrepreneur need to be accepted.
- Strategic plans of the company lay out a canvas in which entrepreneur and other employees see or visualize the ideas that fit well and create synergy with the existing business of the company. Strategic plans follow the corporate

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philosophy and set defined goals on a timeline. Strategic plans also identify the best way of doing business (strategic thrust areas) for the plan period and expect everything that the company would do to follow those thrust areas. Strategic plans, therefore, not only guide the line of creativity but also set healthy rules for negotiation and allocation of capital budget on competing projects.

- Strategic plans and good environment would make the organizational structure for project management quite effective for all tasks related to project management, starting from idea generation to post-completion audit. Separate systems for supporting generation and capturing of ideas must be created. These systems can be a combination of several formal, semi-formal and informal systems. Finally, projects are classified on various bases before the project organization is spelt out so that the stated objectives are attained.
- A company with a well-designed system for idea generation and processing, guided by clearly defined corporate philosophy and supported by well-designed strategic plans, leadership style and organizational structure is better poised to sail through fierce competition with colours of success.

3.7 KEY WORDS

- **Corporate philosophy:** A self-imposed constraint which defines what is acceptable and what is not acceptable to the company.
- **Corporate strategic plan:** A plan that provides impetus and guidance to various business units in the preparation of their own strategic plans, which become a part of the corporate strategic plan.
- **Echo-system:** It is a system that is built around an initial innovation, to finally build the complete set of businesses around it for consumer benefits.
- **Innovation:** It is the introduction of new ideas, things or methods of doing something.
- **Problem inventory analysis:** This is brainstorming around the initial sensing of opportunity. The difficulties associated with opportunity are under scanner in the problem inventory analysis.
- **Strategic planning:** An attempt to attain the firm’s objectives and goals by utilizing the internally available resources for tapping external opportunities.
- **Strategic thrusts:** Ways of doing business to achieve strategic goals.

3.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. What is a business idea?
2. Write short notes on: (i) Criteria for classification of projects; (ii) System for idea generation; (iii) Objectives of an organizational system.
3. How does one create an environment for an entrepreneur?

Long-Answer Questions

1. What are the sources of opportunities? Explain.
2. What are the different methods of generating ideas?
3. Explain the various stages that go in the process of value creation out of a given opportunity.

3.9 FURTHER READINGS

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UNIT 4 PREPARING A BUSINESS PLAN

NOTES

Structure

4.0 INTRODUCTION

In the previous unit, you studied the process of identification of business ideas, methods of generating ideas and recognition of business opportunities.

In this unit, we will study about preparing a business plan. Business plan is an essential and very important document that is prepared with diligence. It comprises several components and contents. The most important elements on which business plan is built include a feasibility study.

4.1 OBJECTIVES

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

- Interpret the meaning and significance of a business plan
- Describe the components of a business plan
- Explain the basics of the feasibility study

4.2 MEANING AND SIGNIFICANCE OF A BUSINESS PLAN

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In this section, you will study the meaning and significance of a business plan.

4.2.1 Meaning

Business plan is a written description of business. It is comprehensive in nature and comprises details like promoters, existing and proposed products and/or services, know-how and techniques intended to use, potential markets and customers, proposed strategies for the marketing of products and services, details of manpower, available or planned infrastructure, sources of supply of input items, organizational structure, estimated costs and revenues, estimated investment in fixed assets as well as working capital, and finally projection of financing needs.

4.2.2 Period

What should be the period of analysis? This question may sound naive; however, it is quite important. Usually, the period of forecast is a matter of the company's policy based on the consideration of factors like product lifecycle, business cycle, rate of change in technology, rate of change in taste, managerial ability to foresee in the future and database available to support forecast. Information technology projects typically can be planned for about three years due to the technological development rate, short product life cycle and uncertainty caused by low entry barrier.

There are other reasons too for limiting the length of period for the financial analysis. Some of them are as follows:

(i) Project report for the loan purpose will be prepared for the period of loan because the lending agency would like to know the project cash flow for the safety of their money, which is loaned for a particular period only.

(ii) Time value- (discounted cash flow) based evaluation techniques are sensitive to the cut-off rate and length of time and their results become less relevant for decision making with the increasing span of time in analysis.

If, for some reasons, the length of analysis is restricted to less than the approximate project life, then it is appropriate to forecast the resale value of all assets at the end of the terminal period, (i.e. end of the analysis period) and incorporate the terminal value in the last year's cash flow for the project. The estimated value of working capital released in the terminal period is also recognized at this point.

4.2.3 Significance of a Business Plan

A well prepared business plan serves several purposes such as:

(i) **Integrated perspective:** A business plan gives multi-year integrated perspective of business. The integration of product and technology

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understanding, understanding of market mechanics and organizational interplay collectively gives a bigger picture through a business plan.

(ii) **Develops common understanding:** Due to integration, the understanding among partners as well as among employees at all level would increase reducing the efforts of coordination and reducing the chances of misunderstanding.

(ii) **Identifies resource requirements:** Although a business plan begins with an assumption, it passes through a stage where resource requirement planning is also done. That helps the business identify the sources of resources, their availability and pricing, among others.

(iv) **Gives a comprehensive estimate of funds requirement:** All assumptions together would identify the short-term as well as long-term funding gaps.

(v) **Facilitates fund raising:** One can plan out working capital financing and project financing requirements ahead of time and avoid crisis situation. Timely action for fund raising would reduce the cost of capital.

(vi) **Getting manpower:** In case of a new start-up firm, a business plan often helps is luring suitable manpower resources. Getting the right type of human resource is a very important for a start-up.

4.3 COMPONENTS OF A BUSINESS PLAN

A business plan is usually divided into some broad components such as:

(i) Table of contents

(ii) Executive summary

(iii) About management and activities and past performance of business, if already in business.

(iv) A brief introduction of business plan

(v) Feasibility report (technical, market and financial)

(vi) Detailed calculations of ratios and analysis of them

(vii) Conclusion

Thus, you can see executive summary gives an overview of the business plan, which would include the purpose of the plan document, scope of work and major findings. Next section is usually about the management or promoters for the existing business and new start-up, respectively. The most important section pertains to details of feasibility study. Three areas of feasibility study are important, namely, technical feasibility, market feasibility and financial feasibility. If a business or a project is subject to environmental clearances, the environmental feasibility is also relevant.

The feasibility study generates financial numbers and non-financial information. They are analysed through various ratios of interest before the final observations and conclusions are drawn. The analysis and conclusion must show financial viability of the business proposal with a view for business plan to become acceptable for consideration by any stakeholder.

4.3.1 Contents of a Business Plan

A brief description of contents of business plan is given as under, and the feasibility study in the next section:

(i) **Description of venture:** For an existing business, the details like date of establishment, journey over time with significant milestones, employee data, sales and profit data over time (if history is too long then selected period of say, five years' data would be enough), organization structure, operating philosophy, vision and mission statements, and details of enabling factors are important.

(ii) **Production plan:** In case of manufacturing activity, the details of technology and its constraints, success factors, realistic assumptions regarding utilization of plant capacity supported with evidences from other businesses, processes, manpower requirement (skilled, semi-skilled and unskilled) as well as their availability, sources of material and several other details that can have an impact on production would become an essential part of production plan. Finally, year-wise production plan in units as well as rupee terms must be presented. In case of services, similar information but with different components would become relevant in production plan. Equipment needed, trained manpower availability, office space, necessary hardware and software, marketing assumptions in terms of demand for services and such other information is used for preparing production plan for a service organization. This plan perhaps can be renamed as 'service plan'.

(iii) **Operations plan:** Several operations have to be carried out with a view to succeed in providing products and services. The business activity must be clearly broken down into the discreet operations and details must be provided how those operations will be performed given the resources. If the operations plan fail then production plan would also automatically fail.

(iv) **Marketing plan:** A business needs to define a market in terms of geographical area or demographic details of potential customers or consumers. Market feasibility report would help in identifying the scope of business opportunity, and from that canvass, a businessman has to determine the right segment of market wherein he would like to do business. Promotion plan, distribution network and other marketing policies are useful in evaluating the potential market for the goods and services offered by the business.

(v) **Organizational plan:** In the absence of strong organizational backing the most lucrative business can also fail measurably. Business operates in a very dynamic environment, whether internal or external. A business

NOTES

organization must develop capability of capturing information regarding the changing external variable that may affect the current business or future opportunities of the business. Internal competency of deciphering the signal picked from the market and responding to it in time is critical for converting plans into a profitable action.

(vi) **Assessment of risks:** The production and marketing plans are usually prepared on the most realistic scenario. If actual scenario turns out to be better than anticipated (sales price is higher, sales quality is higher, expenses are lower, among others), then there is a positive surplus profit. But what if things do not turn out as good as estimates and cost of project goes up, cost of capital is higher, enough capital is not available, sales price remain low, sales quantity is less, expenses are higher, skilled people are not available, among others. The assessment of down-side impact of risk must be assessed, if not upside reward of risk.

(vii) **Financial plan:** The contents of the business plan are now converted into the financial numbers to present the financial plan. The financial plan gives income statements and balance-sheets for the projected period, depreciation schedule, interest payment schedule, working capital schedule, taxability schedule, cash flow statements, working capital financing schedule and schedule of funds to be raised and serviced. The financial plan also includes calculation of several ratios that are useful in the evaluation of funding options. Cost of capital is calculated, net present value is calculated, internal rate of return is calculated and in some cases other needed aspects like pay-back-period and accounting rate of returns are also presented in the financial plan.

Check Your Progress

1. Why are information technology projects typically planned for about three years?
2. What does a business plan begin with?
3. What is useful in evaluating the potential market for the goods and services offered by the business?

4.4 FEASIBILITY STUDY— BASICS

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.

Feasibility study is not conducted for all projects. Small projects like replacement of old assets or any project where certainty level is very high, a feasibility study is not needed. 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.

4.4.1 Areas of Assessment of Feasibility Study

There are basically three types of feasibilities evaluated in the project feasibility study:

- Market feasibility
- Technical feasibility
- Financial feasibility

When projects are evaluated by government or government agencies, economic and social feasibilities are also considered, in addition to environment assessment. Market feasibility is carried out in detail at the early phase of project evaluation. Technical feasibility and financial feasibility are less emphasized in the initial stage, but when market feasibility shows some positive signals, technical and financial feasibilities would assume importance.

4.4.2 Guidelines for Doing a Feasibility Study

If feasibility study is needed then the first would be on market to check whether there is some un-served demand in the market, and if so, where is that market. Technical analysis is carried out only if the business would need some technology that is not used in the region and technological advancement is high. Also, when adoption or deployment of technology could potentially become an issue one would need a detailed technological feasibility study. Financial feasibility study is important for determining the financial viability and desirability of the project. Financial feasibility would draw assumptions from market feasibility and technical feasibility.

4.4.3 Stages of Feasibility Study

You must have noticed that feasibility study is conducted in four stages, which are also the types of feasibility studies given previously. However, in case where a project begins with high degree of uncertainty, multiple feasibility studies are possible. For example, for an entirely new product idea, the initial market feasibility can be studied in brief along with secondary data.

1. Feasibility study – market feasibility

Products where sales potential is high are less risky to invest in. 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

NOTES

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 four 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 4.1, which also shows calculation of demand-supply gap for a particular product in five consecutive years.

Table 4.1 *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.

2. 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 4.1A to 4.1D gives the pictorial presentation of these patterns.

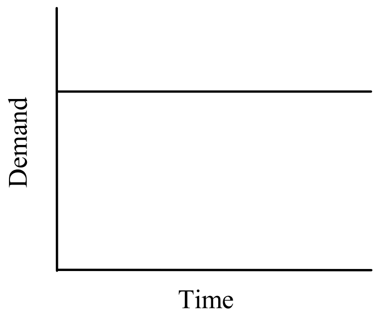

Fig 4.1A *Horizontal Pattern*

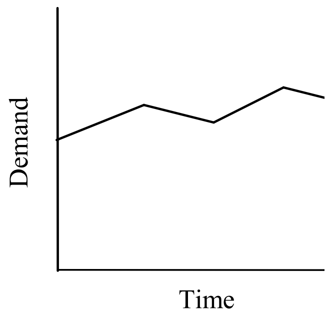

Fig 4.1B *Seasonal Pattern*

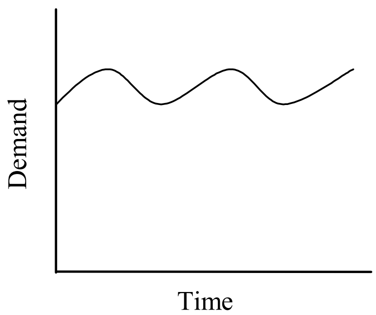

Fig 4.1C *Cyclical Pattern*

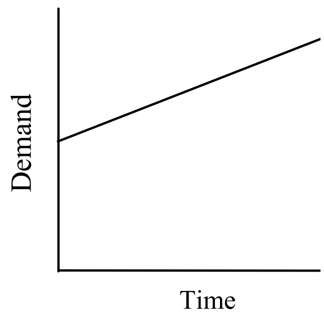

Fig 4.1D *Growth Pattern*

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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.

NOTES

- **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.

3. Technical feasibility

If there is an ample market demand and not enough supply, the focus should shift over to technology. The following inquiries must be made with respect to the technology analysis:

(i) Availability of commercially exploitable technology and its alternatives

(ii) Transferability of those technologies

(iii) Other inquiries about the technologies

- Normal capacity utilization
- Requirement of plant and equipment and fabrication facility

NOTES

- Production process needed
- Possible product mix
- Possible alternate usage
- Flexibility
- Rate of change
- Waste disposal

(iv) Risk Implications

(v) Resource availability

4. Financial feasibility

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. These basic decisions are a prerequisite of financial analysis which are as follows:

(i) **Financing mix and cost:** At this stage, the start-up might not have raised capital for financing the project. However, still the company must make a tentative decision about the financing mix for the project and about the design of instruments for raising funds. The financing mix decision has three purposes:

- investigating the effect of new project financing on the company's capital structure.
- approximating the cost of each type of new funds that will be raised for financing the new project.
- approximating the weighted average cost of capital, which can be used in deriving the cut-off rate required for accepting the new project.

(ii) **Cut-off criterion:** Cut-off decision is a benchmark against which the project cash flow stream is compared to determine whether the project would attain its financial goal. A cut-off rate is sometimes called a go-no-go criterion, hurdle rate, or required rate of return.

An ideal cut-off rate can be calculated in many alternative ways like,

- by adding risk premium in the risk-free rate of return.
- by using the capital asset pricing model (CAPM), if it can be applied to real assets as opposed to financial assets.
- a more pragmatic solution to the cut-off rate decision lies in taking risk-adjusted rate of return. Risk-adjusted rate of return is calculated by adding/subtracting the differential risk from the weighted average cost of capital.

(iii) **Choice of evaluation technique:** A company must select one or more appropriate evaluation techniques. Usually, firms select a set of evaluation

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techniques to attain multiple goals. For example, a firm may use pay-back period (capital recovery period) method as well as net present value method for ensuring good liquidity as well as value creation from the project. Companies also develop a policy for the applications of techniques. These policies vary depending upon the type of project. For example, a project of establishing a new market territory may be evaluated on the basis of accounting rate of return but replacement of machines on the basis of net present value.

(iv) **Project cash flow estimate:** Project cash flow usually has an initial out flow (investment) followed by inflow over a time. The cash flow estimate is prepared using a basic principle that only an incremental cash flow is relevant for a project. After considering the incremental based cash flow over the time, the project cash flows are divided into three categories, namely (a) initial cash flow, which is mostly the outflow, (b) operating cash flow, which come from the operations of the project and (c) terminal cash flow, which comes when the project life is assumed to be over.

(v) **Financial evaluation:** Cash flow alone is not useful in assessing the financial viability of a project. Some analytical tools must be applied to the project cash flow for the evaluation of financial desirability of the project. Use of ratios and application of evaluation techniques are important in the financial viability assessment.

In the capital budgeting evaluation techniques there are profit-based techniques, cash-flow based techniques and discounted cash-flow based techniques.

Success of a project depends on the actual outcome of some key variables. Those key variables are called critical success factors. Each industry has its own critical success factors identified from the experience of businesses. For example, in case of 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. Critical success factors are product and region specific. Some of the factors are project specific and they are specific to the economy and location. Risk is studied in the light of possible variations in the critical success factors.

Check Your Progress

4. When do technical and financial feasibilities assume importance?
5. Mention examples of various patterns of historical data.
6. What is coefficient of correlation?
7. List other names for cut-off rate.

4.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

NOTES

1. Information technology projects typically can be planned for about three years due to the technological development rate, short product life cycle and uncertainty caused by low entry barrier.
2. A business plan begins with an assumption.
3. Promotion plan, distribution network and other marketing policies are useful in evaluating the potential market for the goods and services offered by the business.
4. Technical feasibility and financial feasibility are less emphasized in the initial stage, but when market feasibility shows some positive signals, technical and financial feasibilities would assume importance.
5. There are various patterns of historical data like horizontal pattern, seasonal patterns, cyclical pattern and growth pattern.
6. The correlation coefficient is a calculated number, which indicates the degree to which two sets of numbers are statistically related.
7. A cut-off rate is sometimes called a go-no-go criterion, hurdle rate, or required rate of return.

4.6 SUMMARY

- Projects that involve production of goods and services generate cash flow only if there is enough market and an appropriate and cost-effective technology is available for the production of goods and services.
- Market analysis is essentially the study of demand and supply of goods and services to find a gap. A positive gap exists if demand is expected to be more than supply, which gives an opportunity for the project. There are several statistical models available for projecting demand from the past data of demand and corresponding causal or associated variables.
- The demand for goods and services not existing in the market cannot be estimated using any of the methods. Markets for such products are evaluated based on the understanding of the variables like changing taste or based on the strong conviction that a particular advertisement campaign would create demand.
- The technology essential for the proposed project must be available; it must be commercially exploitable; it must be transferable to the location selected; and it should have affordable investment, operating costs and risk. Technical analysis involves study of these questions.

- While studying market and technology, it is important to identify and understand the 'critical success factors' responsible for the success or failure of the project.
- Market feasibility gives the basis for the development of assumptions like sales revenue and marketing expenses; technical feasibility gives the basis for the assumption of investment required in the project, cost of operating the project and so forth. These assumptions are useful in assessing financial feasibility.
- In financial feasibility, several initial decisions have to be taken like financing mix, cut-off rate and evaluation technique. The cash flow stream is estimated based upon the selected techniques which are used for evaluating a project. If financial evaluation indicates that the proposed project would create value, then the project is considered viable.

4.7 KEY WORDS

- **Business plan:** Business plan is a written description of the business. It is comprehensive in nature and comprises details like promoters, existing and proposed products and/or services, know-how and techniques intended to use, among others.
- **Cut-off decision:** A benchmark against which the project cash flow stream is compared to determine whether the project would attain its financial goal.
- **Feasibility study:** Project feasibility study is an initial study in which market feasibility, technical feasibility and financial feasibility are studied.
- **Market feasibility study:** Market analysis aimed at assessing the potential sales revenue from the proposed project.
- **Moving average method:** A method used in forecasting for a short period. This method reduces the randomness in variable because the average of the last few observations is considered as the forecast value, unlike the last observation in the naïve method. However, change in pattern is not captured in this method.
- **Payback period method:** A cash flow method which determines the period in which the initial investment is recovered.
- **Project cash flow:** The net change in cash flow of the entire firm if the proposed project is accepted.
- **Qualitative techniques:** Techniques aimed at forecasting changes in a basic pattern and 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.

4.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. Write a short note on the period of analysis for a business plan.
2. What is the significance of a business plan?
3. List the broad components of a business plan.
4. List the methods that can be used for determining the pattern of past demand.
5. What are the three categories of project cash flows?
6. Write a short note on technical feasibility.

Long-Answer Questions

1. What are the contents of a business plan?
2. Discuss the market-feasibility study in detail.
3. Explain the demand forecasting techniques.
4. What do you understand by financial feasibility?

4.9 FURTHER READINGS

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BLOCK - II
FINANCING AND LAUNCHING OF NEW VENTURE

NOTES

UNIT 5 FINANCING THE NEW VENTURE

Structure

5.0 INTRODUCTION

NOTES

In the previous unit, you studied about the significance of a business plan, the various components of a business plan and the basic parameters to be assessed while conducting a feasibility study.

Financing of a new venture is a critical decision for small entrepreneurs and large businesses alike. It is important for the viability of a project. This unit will discuss in detail several decisions associated with the financing of a project and providing the working capital. These decisions include an ideal mix of equity and debt and its implications on cost of funds, sources and types of equity and debt funds, and project finance. You will learn about project finance in India and will also be introduced to the issues involved in infrastructure project financing.

5.1 OBJECTIVES

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

- Explain the significance of new venture financing in project management
- Describe the various types of ownership securities
- Recognize the importance of venture capital
- Identify the type of debt securities
- Analyse debt capacity and evaluate the financing options from the risk perspective
- List the financial institutions and banks that finance a new venture

5.2 IMPORTANCE OF NEW VENTURE FINANCING

The first concern about project financing is to make sure that sufficient funds are available in time for the construction of a project. Funds needed for financing a project is equal to the capital investment in project and core working capital needed for putting the new venture on stream. However, the total list of concerns should be: (i) access to different sources of funds, and (ii) selecting the sources of funds suitable for the business, so that the cost of each source of funds as well as the overall cost of funds is minimized.

We can address these two main concerns by studying several topics like forms of business organization, sources of funds, ideal debt-equity ratio; and designing a security. Actual selection of project financing source will depend on the market situation at the time of raising funds from the market. Internal needs of the firm from the perspective of cost of funds, risk implications, liquidity needs and future growth needs have to meet with the financial market situation.

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5.2.1 Types of Funds Needed

Any business would be in need for two types of funds, (i) working capital funds and (ii) project funds. Project funds are invested in the project for a long period of time. This will include all initial cash flows, like cost of the project and preliminary expenditure in promoting a project and initial losses on operations before the project stabilizes its operating milestone. It also includes core working capital requirements.

However, the working capital requirement is always changing due to various reasons. Some resources are bought in the season, demand for the product is different in different seasons, process of goods and services bought and sold vary over time, payment terms with suppliers may be different than the payment terms with customers and billing cycles vary. These and many more factors together cause cyclical pattern in the working capital requirement.

5.2.2 Rights and Obligations of Fund Providers

Sources of funds vary in their basic features (rights and obligations of supplier of funds as well as that of the business who obtains funds from the suppliers). The basic three features are:

- Right to get return
- Right to vote
- Tax implication

Ownership funds and debt funds are the two main classifications of sources of funds. One can also include subsidy and tax incentives as the sources of funds. These sources are available in a limited way subject to qualification of projects and businesses. Usually, small entrepreneurs and export-oriented units qualify for subsidy on their qualified investments. Tax incentives are also available to desired investments made by any firm.

Check Your Progress

1. What are the two types of funds, any business would be in need of?
2. Mention the three basic features of sources of funds.

5.3 TYPES OF OWNERSHIP SECURITIES

For non-corporate (sole-proprietorship and partnership) businesses there is only one type of ownership security available and that is the owners' capital. Owners (sole-proprietor or partners) bring capital and enjoy the rights to participate in managing business (depending upon agreement) and the right to share profit or loss (usually in the proportion of every partner's share in capital). Therefore, the following material on the types of ownership security is more appropriate for corporate form of business.

NOTES

5.3.1 Common or Equity Shares

In case of a company, total ownership fund is called a 'stock' and it is divided into smaller units called 'shares' or 'common shares'. This allows a company to obtain funds from several owners, who are called 'shareholders' or 'members'. However, a private company can issue shares only privately through friends and relatives but a public company can issue shares to the public.

(i) Types of common shares

Firms issue different types of common shares (so common shares are not common anymore). In India, the first time a different type of common share issue opened was in the end of September 2008 by Tata Motors. At that time, the company announced to issue two types of shares on pre-emptive right basis; one at ₹ 340 on one-vote-one-share basis and another at ₹ 305 with lower voting right (one-tenth vote per share) and 5 per cent extra dividends. This created two categories or types of common shares.

(ii) Suppliers of common share capital

(a) Promoters
(b) Friends and relatives (sometimes called 'love money')
(c) General public
(d) Private Equity
(e) Venture capitalists
(f) Angel capitalists
(g) Charitable venture capitalists

5.3.2 Preference Shares

Preference shares are also ownership shares but with a difference. Preference shareholders enjoy preferential rights over the rights of equity shareholders. They have a right to get dividends (subject to an upper limit specified in the issue document) before any dividend is paid to the equity shareholders. They also have a right to get their money back before anything is paid back to the equity shareholders in the event of winding up of the business and if there is a surplus of proceeds after paying all the liabilities of the company.

5.3.3 Deferred Shares

Deferred shares are the type of ownership security that offers a more proportionate right of voting. The owner of one deferred share can have more than one vote, depending upon the terms of issue. In exchange of these extraordinary voting rights, the deferred shareholders' right to get dividend is deferred until a specified amount of dividend is paid to the equity shareholders.

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5.3.4 Subsidy and Tax Incentives

The central government and state governments offer incentives for investment through subsidies, tax incentives and concessions in land and utility prices. Schemes vary from state to state. Usually, subsidy and tax incentives are offered for encouraging small entrepreneurs, women entrepreneurs and for encouraging investment in desired locations and businesses. Subsidy is shown as capital and is tax-free.

Bootstrap financing is not a separate source of funds, but an approach for either raising funds or reducing funds requirements. This is done usually for funding the organic growth of a business, without significantly using external sources of funds. Bootstrap entrepreneurs use all personal resources, borrowing from family and friends, credit from suppliers, cash based sales, cost reduction, working capital reduction, cash flow management, buying used equipment or leasing them, among others.

5.4 VENTURE CAPITAL

Venture capitalists have come into being to help people with idea but not much money. Oxford dictionary defines venture capital as ‘capital invested in a project in which there is a substantial element of risk, typically a new or expanding business’. As per this definition, one would safely conclude that venture capital fund is available for a start-up firm and small businesses that might have a potential of long-term growth and profitability.

5.4.1 Characteristics of Venture Capital – Venture Capitalist

All venture capital and venture capitalists are equal in their characteristics, though they defer in terms of their expertise and focus area. There are three very basic characteristics that distinguish venture capital from other sources of equity funds. These three characteristics are:

- it is equity investment or quasi-equity investment
- it is a long-term investment, and
- it is an active form of investment in equity.

The participation of venture capitalist in equity or quasi-equity is without any collateral. They take same risk as any ordinary equity shareholder would take. Venture capitalists invest significant amount of money for a longer period, and therefore, they participate in the management of the firm, they participate in the board meetings, help in converting idea into a marketable commodity, and assume greater risk, including liquidity risk. They help in establishing the firm, introducing the product, managing growth and so on before they stage an exit.

NOTES

5.4.2 Eligibility Criteria for Venture Capital Financing

A venture capitalist will use some eligibility criteria before a proposal of funding a start-up is short-listed. New Brunswick Innovation Foundation, a venture capitalist, has listed on their website the following characteristics as eligibility criteria for venture capital financing:

- a solid management team
- an innovative product, service or technology
- an attractive market
- a sustainable competitive advantage
- realistic business plan and financials
- an identifiable exit strategy for the foundation within a reasonable timeframe.

5.4.3 Opportunities of Venture Capital Financing

Every venture capitalist has developed one or few expertise fields and they do not look beyond those areas when they select a venture for funding it. Corporate venture capitalists may go with existing businesses for funding their risky ventures, whereas private venture capitalists may look for small entrepreneurs for funding their start-ups.

Five types of funding opportunities exists, namely: (i) seed money fund, (ii) start-up capital, (iii) early capital, (iv) growth capital, and (v) late stage capital, provided the venture fits into their domain of expertise. Seed money fund is made available if venture capitalist agrees in principle to join the venture, but more information is needed for studying the venture's viability and success. Early capital is provided for establishing a firm and launching the business of the start-up. Growth capital is further provided when growth of business puts pressure on liquidity as well as creates demand for fresh investment. Despite continuous financial support there can be some unexpected situations from which the entrepreneur has to be bailed out, for which late stage capital is often provided by the venture capitalist.

Government agencies also have been created to act as venture capitalists to support the weaker section of the business. For example, SIDBI Venture Capital Limited, established by the Small Industries Development Bank of India (SIDBI), has set up venture funds.

5.4.4 Sources of Venture Capital

Conceptually, venture capitalists can raise money from all sources. But, keeping in mind the nature of business of venture capitalists and risk they take, not all options would be available to them. There may be a very few wealthy individuals who can afford to take risk and invest in a venture capitalist firm; but many of them would rather maximize their returns by investing in buyout wing of private equity. Venture capitalists also provide technical and managerial expertise and keep a say in the firm's decisions.

NOTES

5.4.5 Angel Capitalists

Angel investors are those that 'save struggling firms with both finance and know-how when no one else will'. There is hardly any angel investing in India but in the West this is more common.

5.4.6 Charitable Venture Capitalists

Charitable venture capitalists are not present in the Indian market but the West has adopted this mechanism for regional growth. These are venture capitalists with a charitable purpose, which fund the early-stage high potential small businesses. Charitable venture capitalists operate exactly like venture capitalists but have a broader list of businesses that they support (usually ones that are likely to result into a positive regional growth in terms of employment and tax revenue).

Check Your Progress

3. Mention the type of share which offers a more proportionate right of voting.
4. What are the sources for bootstrap financing?
5. Define seed money fund.

5.5 TYPES OF DEBT SECURITIES

Debt funds or loan funds are different from ownership funds in terms of the rights of lenders. Suppliers of debt funds are entitled to interest (rather than dividends) on their funds at a rate decided in the agreement and that is payable by the firm whether the firm earned profits or not. However, the suppliers of funds have no right to manage the firm or appoint their representative on the board of directors. Rights and obligations of lenders and borrowers are determined by the terms of agreement. Sources of long-term debt, used for financing projects, can be mainly divided in three categories, namely (i) term loan, (ii) lease and (iii) debentures or bonds.

Loan or debt can be designed with several features. The list of features is given in Table 5.1.

NOTES

Table 5.1 Features of Debt Securities

- Par Value
- Maturity Period
  - Call and put provisions
  - Deferred callable bonds
- Maturity Value (at par, at premium or at discount)
- Interest
  - Rate of Interest
    - Fixed rate
    - Floating (variable) rate
    - Reverse floaters
    - Asset backed
    - Catastrophe bonds
  - Timing of Payment of Interest
    - At regular interval of time
    - Ballooning
    - On maturity
  - Method Payment
- Other Provisions
  - Security
  - Dividend restrictions
  - Subordination of future debt
  - Conversion

5.5.1 Term Loan

Term loan is usually supplied by commercial banks and financial institutions. Term loan is for a specific term (period) at a fixed or variable interest rate, with interest payable periodically, issued against some security and usually with several negative covenants like periodic reporting of accounting and other information, prior approval of the lender before some activities or changes are undertaken, appointment of members of board of directors and so on.

5.5.2 Lease

Lease is of two types, operating and finance (or capital) lease. Operating lease implies short-term rights of use of an asset. Operating lease does not amount to financing acquisition of an asset. Finance lease is for almost the entire life of an asset and, therefore, it is a mode of financing.

5.5.3 Debentures and Bonds

Companies can divide their loan requirements into units of small denominations and issue them to several parties. These units are called ‘debentures’ or ‘bonds’. If these units are backed by collateral, then they are called ‘bonds’; otherwise they are called ‘debentures’. Important features of debentures and bonds are maturity amount, maturity date, and interest, among others.

A mix and match of features can create a new type of bond. Some important types of bonds are as follows:

NOTES

- Zero-coupon bonds
- Floating rate bonds
- Reverse floaters
- Asset backed bonds
- Catastrophe bonds

Some securities are designed to carry mixed features of ownership securities and debt securities. These are known as hybrid securities. Some important hybrid securities are preference shares, redeemable or irredeemable preference shares, cumulative or non-cumulative preference shares, participative or non-participative preference shares.

Preference shares and bonds can be convertible also. Convertible securities are often called mezzanine securities. They are considered hybrid securities because at the time of issue, they are either preference shares or bonds but are convertible into equity shares on some future date. Conversion may be either at the option of the security holder or it can be compulsory. Conversion time and conversion ratio are pre-determined.

When bonds are issued with the right to get a certain number of equity shares on or after a certain date in the future, they are called 'bonds with warrants'. Warrant gives the holder of it a right to get a certain number of shares on a future date at a favourable price. These warrants are detachable, which allow a bondholder to sell the warrants separately before they are due for shares. Warrants make bonds cheaper because of the potential capital gain after the exchange of warrant for shares. Also, they allow the firm to increase its shares without incurring any floatation cost and while mostly maintaining the debt-equity ratio.

Check Your Progress

6. What are the categories of sources of long-term debt?
7. List some of the important hybrid securities.

5.6 DETERMINING IDEAL DEBT-EQUITY MIX

Debt is essential for financing the project and it also gives a leveraging effect. Leveraging effect magnifies the owners' profit or loss depending upon the cost of debt and gross profit margin. Too much debt may cause a harmful effect on the owners' profit. Ideal debt-equity ratio can be determined in a few ways, namely, through: (i) pre-determined standard of debt-equity ratio, (ii) interest cover ratio, (iii) debt-service cover ratio and (iv) degree of total leverage.

NOTES

5.6.1 Predetermined Standard of Debt-Equity Ratio

Some believe that ideal debt-equity ratio is industry specific and all the firms in the industry should have the same debt-equity ratio. Usually, they prescribe 2:1 ratio as ideal for an average industry and recommend a lower one for a risky industry and a higher one for a less risk industry.

5.6.2 Interest-Cover Ratio or Times-Interest-Earned (TIE) Ratio

A healthy level of borrowing will ensure that a firm earns enough profit to pay interest and is still left with enough for dividends payment and retention. Many lenders use a thumb-rule that TIE ratio should be minimum 3.

This is a better approach than the pre-determined standard debt-equity ratio for a given industry. However, TIE-based debt-equity approach considers the financing risk in isolation without considering investment (or operating) risk taken by the firm.

5.6.3 Determining Debt-Equity Ratio via Debt-Service-Coverage Ratio (DSCR)

Some prefer the debt-service-coverage ratio (DSCR) approach ideal for determining the debt-equity ratio.

This approach implies that healthy borrowing practice is one where the firm is able to service its debt from the cash operating profit and still is left with a positive surplus from the profit. Usually, a DSCR of 1.5 on an average for the period of loan is considered good. This is somewhat a better approach than TIE-based debt-equity.

5.6.4 Determining Debt-Equity Ratio via Degree of Total Leverage

The concept of leverage is useful in determining the ideal debt-equity ratio for a firm. An ideal debt-equity ratio is the function of many internal and external variables. Uncertainty of sales revenue and expenses, degree of operating leverage, rate of interest on borrowings and willingness of financial markets for taking risk are important among them. In leverage-based debt-equity approach, the desired degree of total leverage is determined and then for a given degree of operating leverage, the desired degree of financial leverage is calculated and from there, the desired interest expense is calculated and finally, debt amount is calculated.

Check Your Progress

8. What does the TIE ratio consider?
9. Mention some of the variable which forms as the function for an ideal debt-equity ratio.

5.7 FINANCIAL INSTITUTIONS AND BANKS

NOTES

Funds are provided by individuals or financial institutions. The canvas of financial market can be divided in two main parts:

(i) Money market
(ii) Capital market

5.7.1 Money Market

- **Banks:** Main players in the money market are banks who specialize with short-term movement of money and are regulated by the Reserve Bank of India. Banks typically accept deposits from various individuals and businesses and provide loans to individuals and businesses. Banks are also an important link in export-import operations wherein it provides letter of credit as a guarantee for payment of dues upon receiving the goods by the other party, whom one many not know because of cross-border transactions.

5.7.2 Capital Market

Capital market has two broad segments, namely:

(i) Primary market
(ii) Secondary markets

(i) **Primary Market:** Issue of shares and bonds are made in a primary market where the issuer firm and investing public make direct contract among themselves, sometimes facilitated by an expert mediator like merchant bankers.

(ii) **Secondary Markets:** Once a script is issued in the primary market, an investor can liquidate the holding by selling it in the secondary market. Stock markets are secondary markets where potential buyers and sellers come together and through demand and supply of the given security determine the price and exchange the security. The secondary market offers liquidity to the securities which are issued for a long period.

5.7.3 Financial Market Institutions

There are many players in the primary and secondary markets. Here, we will briefly mention some of the most important among them.

(i) **Merchant banker (investment bank):** Merchant banker or investment bank provide services for the public issue of shares and bonds.

NOTES

(ii) **Institutional investors:** There are mainly three categories of institutional investors, namely:

(a) Pension funds

(b) Mutual funds

(c) Insurance companies

5.7.4 Project Financing in India

All nations, especially developing ones, regulate project financing in many ways. In the following section, we will discuss four aspects of financing with special reference to India.

(i) SEBI guidelines

Public issues of shares and bonds are subject to rules and guidelines issued by the Securities Exchange Board of India (SEBI). This document is available with the name 'SEBI Disclosure and Investor Protection (DIP) Guidelines, 2000' This was replaced by the SEBI (issue of Capital and Disclosure requirments) regulations, 2018. Public companies, unless otherwise banned, are allowed to issue securities to the public only after satisfying all conditions related to filing and approval of offer document (called prospectus).

(ii) Financing of small scale industries (SSIs)

Small scale units are very special to all countries. They provide opportunities for employment, distribution of wealth and low-cost supplies to many large firms. Central and state governments have their policies for encouraging small entrepreneurs to attain their macroeconomic goals of employment and distribution of wealth.

(iii) Direct assistance schemes

SIDBI directly assists SSIs under the Project Finance Scheme, Equipment Finance Scheme, Marketing Scheme, Vendor Development Scheme, Infrastructural Development Scheme, ISO-9000, Technology Development & Modernization Fund, Venture Capital Scheme, assistance for leasing to NBFCs, SFCs, SIDCs and provides resource support to institutions which look after the development and financing of small scale sector. These schemes are mainly targeted at addressing some of the major problems of SSIs in various areas, like high-tech project, marketing, infrastructural development, delayed realization of bills, obsolescence of technology, quality improvement, export financing and venture capital assistance.

(iv) Indirect assistance schemes

Under its indirect schemes, SIDBI extends refinance of loans to small scale sector through primary lending institutions (PLIs) viz., SFCs, SIDCs and banks.

NOTES

(v) Promotional and development activities

SIDBI is actively involved in promoting tiny and small-scale industries by means of its promotional and developmental activities through suitable professional agencies for organizing entrepreneurship development programmes, technology up-gradation and modernization programmes, micro credit schemes and assistance under *mahila vikas nidhi* to bring about economic empowerment of women, especially the rural poor by providing them avenues for training and employment opportunities.

(vi) Infrastructure projects: An introduction

Infrastructure projects are very critical from the perspective of economic growth of any nation. These projects have a very long gestation period with very uncertain and long period of benefit streams, making it very unattractive for private businesses to make investment in this area. For various types of infrastructure, various policies are announced. The policy statements have several provisions like inviting participation of the domestic private sector as well as foreign investors, relaxed regulations, among others. This initiative can succeed only with very innovative structure of guarantees and financing of infrastructure projects.

(vii) Infrastructure project financial risks

Though the project risk is managed through guarantees, financing risk is plenty for the infrastructure projects. Infrastructure projects need a large amount of funds and, therefore, they have to rely heavily on debt funds as against equity funds. For example, the Government of India would permit 1.6:1 debt-equity ratio for electricity generation companies. Given the size of operating fixed costs, this ratio is very high. On the other side, such projects have natural asset-liability mismatch, which increase the risk further. Assets of such projects are for a longer life (thirty years for road projects); whereas the lender of money would be hardly ready to make such long commitments.

(viii) Financial arrangements for infrastructure project

The financial risk must be reduced so that the infrastructure project firm can access cheaper funds. Some special arrangements are needed for reducing the financing risk or default risk to make funds cheaper for such projects. A complex arrangement is created for mitigating a part of the default risk and financing risk. Figure 5.1 gives a snapshot picture of the complex arrangement. The real-life arrangement is usually more complex than what you see in Figure 5.1.

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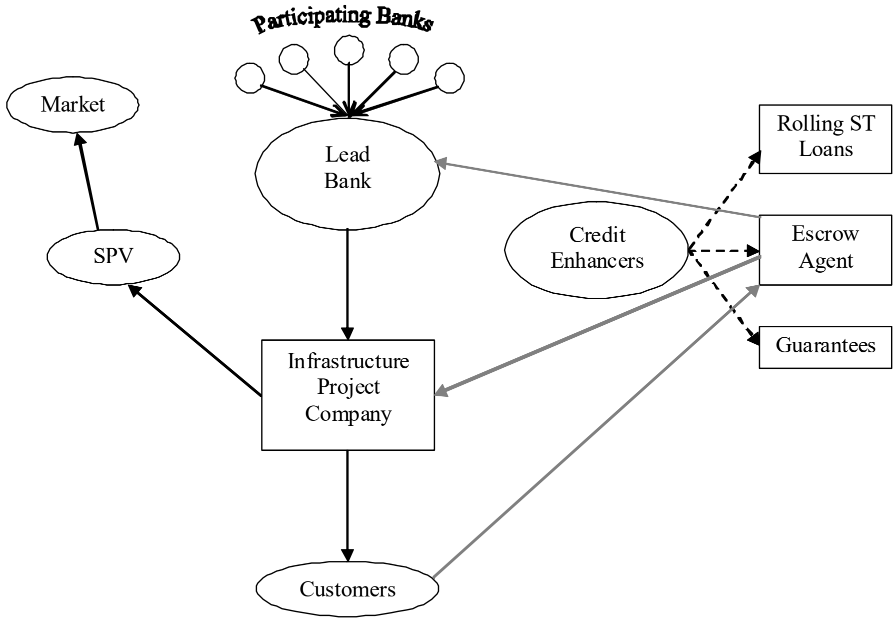

Fig. 5.1 *Risk Mitigation Arrangements for Infrastructure Projects*

Lead bank

Infrastructure project firm gets contract from the government. The firm will identify a lead bank, which works for a fee and makes financing arrangements. The financing arrangement may be in the form of a consortium loan. In addition to making consortium, the lead bank will assume a role of a front financier and would guarantee a long-term (say, thirty years) loan though the consortium members may offer only a medium-term loan (say, five years). That means lead bank guarantees a rolling loan for long-term (thirty years).

Escrow agent

Still default risk persists because of high operating leverage and uncertain income level. An escrow mechanism is created for mitigating this risk. Escrow is a tri-partite arrangement among the infrastructure project firm, the lead bank and an escrow agent. The escrow agent would be usually a bank, who keeps an account in which all collections of the infrastructure firms are deposited (say, toll collections, or electricity bills payments). The escrow agent would make payment of interest on loan to the lead bank from this account and oversee the withdrawal of funds by the infrastructure firm from this account. The escrow agent charges fees for this service.

Guarantees

Despite the escrow mechanism, the default risk is not fully mitigated. If the firm's revenue source is inadequate, default risk will be experienced. Therefore, sometimes the government would provide guarantee against default and undertake the responsibility of payment of obligations to the funding agencies. This would reduce the default risk premium to zero and cost of debt will reduce. The government may also offer a rate guarantee to the infrastructure project firm. Rate guarantee also reduces cost of equity because this in a way is a guarantee of the net profit of the firm.

Special purpose vehicle (SPV)

An SPV is also known as a special purpose entity (SOE). An SPV is a separate firm either totally independent of the infrastructure firms or a partly-owned or a fully-owned subsidiary of the infrastructure project firm. SPV operations vary in nature but the baseline operation involves transfer of risks or accounting entries from the main firm to another firm, to clean up the main firm's books of accounts.

Check Your Progress

10. Mention the three categories of institutional investors.
11. What are some of the major problems of SSIs which get targeted assistance?
12. Mention the entities amongst which an escrow arrangement is done.

5.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Any business would be in need of two types of funds, (i) working capital funds and, (ii) project funds.
2. The three basic features of sources of funds are:
   - Right to get return
   - Right to vote
   - Tax implication
3. Deferred shares are the types of share which offer a more proportionate right of voting.
4. Bootstrap entrepreneurs use all personal resources, borrowing from family and friends, credit form suppliers, cash-based sales, cost reduction, working capital reduction, cash flow management, buying used equipment or leasing them, among others.
5. Seed money fund is made available if venture capitalist agrees in principle to join the venture, but more information is needed for studying the venture's viability and success.
6. Sources of long-term debt, used for financing projects, can be mainly divided in three categories, namely, (i) term loan, (ii) lease and, (ii) debentures or bonds.

NOTES

7. Some important hybrid securities are preference shares, redeemable or irredeemable preference shares, cumulative or non-cumulative preference shares, participative or non-participative preference shares.
8. The Times-Interest-Earned (TIE) ratio considers the financing risk in isolation without considering investment (or operating) risk taken by the firm.
9. An ideal debt-equity ratio is the function of many internal and external variables. Uncertainty of sales revenue and expenses, degree of operating leverage, rate of interest on borrowings and willingness of financial markets for taking risk are important among them.
10. There are mainly three categories of institutional investors, namely: (a) Pension funds, (b) Mutual funds and, (c) Insurance companies.
11. Some of the major problems of SSIs which get targeted assistance are high-tech project, marketing, infrastructural development, delayed realization of bills, obsolescence of technology, quality improvement, export financing and venture capital assistance.
12. Escrow is a tri-partite arrangement among the infrastructure project firms, the lead bank and an escrow agent.

5.9 SUMMARY

- The first concern about project financing is to make sure that sufficient funds are available in time for the construction of a project.
- For non-corporate (sole-proprietorship and partnership) businesses there is only one type of ownership security available and that is the owners' capital.
- Venture capitalists have come into being to help people with idea but not much money.
- Debt funds or loan funds are different from ownership funds in terms of the rights of lenders.
- Debt is essential for financing the project and it also gives a leveraging effect.
- Funds are provided by individuals or financial institutions. The canvas of financial market can be divided in two main parts as (i) money market, and (ii) Capital market.

5.10 KEY WORDS

- **Angel capitalists:** Investors who save struggling firms with both finance and know-how when no one else is interested in them.

NOTES

- **Hybrid securities:** Securities designed to carry mixed features of ownership securities and debt securities.
- **Operating lease:** Short-term rights of use of an asset.
- **Primary market:** This is a market in which a firm that wants to raise capital either through equity issue or debt instrument, directly from the investors.
- **Project financing:** Activity concerned with ensuring that sufficient funds are available for constructing a project; ensuring that there is access to different sources of funds and selecting the most suitable sources.
- **Secondary market:** Secondary market is one where investors buy and sell the securities to gain liquidity and also the best potential returns from their investment.
- **Term loan:** Loan supplied by commercial banks and financial institutions for a specific term at a fixed or variable interest rate payable periodically, issued again some security.
- **Venture capital fund:** A fund formed with the purpose of finding and providing equity capital to high potential growth firms or ventures that may be potentially profitable but very risky.

5.11 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are ownership funds?
2. Write short notes on: (i) preference shares, (ii) deferred shares and (iii) subsidy and tax incentives.
3. Briefly explain the five types of funding opportunities for venture capitalists.
4. Write a short note on financial arrangements for infrastructure project.
5. Explain the importance of new venture financing.
6. Explain common or equity shares.

Long Answer Questions

1. Describe the methods by which the ideal debt-equity ratio can be determined.
2. What are the characteristics of venture capital?
3. Mention the sources of venture capital.
4. Explain different types of debt securities.
5. Discuss the role of various financial institutions and banks in providing funds for projects.

NOTES

5.12 FURTHER READINGS

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NOTES

UNIT 6 LAUNCHING THE NEW VENTURE

Structure

6.0 INTRODUCTION

In the previous unit, you studied the significance of new venture financing in project management, the various types of ownership securities, importance of venture capital, and the project financing activities in India.

In this unit, first you will learn about the different forms of business organizations that a start-up business can choose from, as the choice has implications on the benefits to the business. After that we will look at various laws related to protection of intellectual properties. Getting patents for innovations, copy right for creation, maintaining trade secrets and obtaining trademarks are all in the business interest. Being aware of those laws that govern the start-up activities and also operations is essential. An entrepreneur must have the basic awareness of laws related to taxations, workers and others. This unit also aptly describes how to market the new venture and issues related to day-to-day operations, like procurement of inventory and use of information technology.

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6.1 OBJECTIVES

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

- Explain the different forms of business organizations and also the franchising possibilities
- Identify the different acts that protect intellectual property
- Describe the methods used to market new ventures

6.2 CHOOSING THE LEGAL FORM OF NEW VENTURE

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.

6.2.1 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.

6.2.2 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.

6.2.3 Corporate Form of Business Organization

Instead of a partnership, one can form a company by registering the firm under the Companies Act, 2013. 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 6.1.

Table 6.1 *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

Having briefly discussed the basic forms of business organization, let us delve into the sources of funds.

6.2.4 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.

Check Your Progress

1. Which type of business organization has limited access to funds?
2. State the minimum number of members to form a public company.

6.3 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.

6.3.1 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, 1957and (iv) the Trade Secret.

(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. The latest amendment done to the Act was in 2010.

"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

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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).

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(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.

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.

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The latest amendment to the Act was done in 2012.

(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.

6.3.2 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, 2013, 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
- 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

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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. The introduction of Goods and Services Tax (GSt) and the act and rules, has changed the manner in which business operations are handled.

Check Your Progress

3. What are usually a combination of a character, word, name, design, colour and any combinations of these?
4. Mention the duration of a copyright.
5. With whom are the non-disclosure agreements signed?
6. What is a security system in case of trade secrets that businesses should make?

6.4 MARKETING THE NEW VENTURE

Marketing is a function over which we can have only an influencing power but hardly any control over the outcome. Therefore, marketing function is very important especially for a new enterprise. The market analysis is done before a business plan is prepared and it is included in the business plan, i.e., at the project phase of a proposed business.

6.4.1 Market Assessment

Market is first assessed when a business plan is prepared. That is usually broad base, primarily aimed at checking whether there is gap between demand and supply if the product or service that will be offered by the entrepreneur is an existing product with or without modifications. In case of a new product, the market assessment at time is just an informed evaluation of potential market.

Market assessment aims at defining the market that would be most appropriate for the product and that would give strongest opportunity for the long-term growth. This involves matching the product with customer needs. This strategy of defining the market segment is derived from customer research and competitive analysis.

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6.4.2 Impact of Market Dynamics

An entrepreneur must understand the market dynamics. Conceptually, demand and supply determine the price. Demand and supply constantly change and, therefore, pricing mechanism becomes dynamic, which is called market dynamics. Several factors play a role in affecting supply and demand and thereby, the prices of products. Competitors' price, income level, employment level, inflation, production level, government policies and a host of other factors individually and collectively affect the pricing of a product. Then, one has to watch those few critical key variables and quickly determine the changing impact on pricing.

However, if product differentiation is created then the market dynamics may not be the same for competitors. In that case differentiation itself can offer immunity to pricing to an extent.

6.4.3 Achieving Market Acceptance

The proof of success is finally in attaining the sales level at profitable conditions. The essence of it is in achieving market acceptance of products and services. Start-ups have a greater risk in achieving market acceptance than the firms already in business. However, for the existing business too market acceptance of a new product is risky.

Poor product design, poor and inconsistent quality, improper marketing, unfocussed sales efforts and unclear understanding of the market are the major reason for not gaining market acceptance. Product design and quality has always remained key to long-term success. One should be reasonably certain about the target market and should develop ability to read the market signal and analyse them without any bias to remain successful in achieving market acceptance.

6.4.4 Day-to-Day Operation

There are several aspects of day-to-day operations. Procurement, storage, production, transportation, inventory holding, sales, collections, maintenance, man-management and several other functions together can make operations possible. In today's world, management of information technology is also a matter of daily operations. However, we will discuss only two important aspects of day-to-day operations here. They are namely, (i) procurement of material-inventory and (ii) use of information technology.

(i) Procurement of material-inventory

Material procurement is a process of buying material at the right price, at right time, in right quality, in right quantity and from the right supplier or vendor.

Low price is necessarily not the right price of a material. Right time implies that the material must come in stores just in time when it is needed for production. If material comes early then storage costs increase and if it is late than manufacturing would suffer. Right quality does not imply the best quality, but the

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quality that suits best for the quality of end product planned by the firm. Material specifications are important for getting the right quality and also the quality inspection when the material is received. Right quantity of purchase would enable the firm to keep the lowest amount of stock of material without jeopardizing the manufacturing activity and at the lowest cost of material procurement. Right supplier is one with whom doing business is a win-win situation, who is reliable, understanding and honest. A right supplier would honour all his promises and supply the required material at the right time in the right quantity and at fair price.

Usually different models are available for determining the ordering quantity, timing for ordering, inventory levels and other, so that the cost of inventory is minimized without affecting the smooth manufacturing of operations. Also, a firm has to develop several policies related to purchase after doing the inventory analysis. Usually ABC (always best control) analysis is done to prioritize the inventory for best managerial attention.

Today, outsourcing is more common; procurement function has assumed significant importance and this discipline has developed into a 'supply chain management' function even at a global level. Success of most international firms depends on the effective supply chain management.

(ii) Use of information technology

Information technology (IT) has enabled organizations across the world to work in an efficient manner. Rationale use of IT would enhance the efficiency and improve response cycle to changing market dynamics and to changing other internal or external factors. ERP (enterprise resource planning) systems are available and some portion of it tailored for the firm's needs. ERP is capable of integrating all processes and data in a single system for its users. Data capturing is essential in the use of ERP, but there are many devices available whereby many data can be captured as things happen.

In addition to ERP, information technology comes handy for internet marketing, e-mail marketing, SMS marketing, web-hosting, promotions and client network at very affordable expense.

However, like any other technology, information technology comes with costs. Initial investment and implementation costs are usually high, trouble shooting and constant update cost money on an ongoing basis, skilled employees, which are scarce, have to be employed, people have to be trained, and security breaches do happen costing money and sometimes reputation.

However, it is essential to make a judicious decision about the degree of information and communication technology that one must accept after assessing the pros and cons on short-term as well as long-term basis.

Hence, in a nutshell, the steps for starting an enterprise may be represented as:

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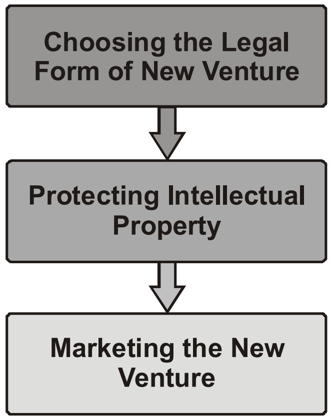

Check Your Progress

7. List some of the factors which play a role in affecting supply and demand and thereby, prices of the products.
8. What does right quality mean in case of material procurement?

6.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Sole proprietorship is the type of business organization has limited access to funds.
2. A public company can be formed with minimum seven members and has no upper limit on the number of membership.
3. Trademarks are usually a combination of a character, word, name, design, colour and any combinations of these.
4. 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.
5. 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.
6. 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.

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7. Several factors play a role in affecting supply and demand and thereby, the prices of products. Competitors' price, income level, employment level, inflation, production level, government policies and a host of other factors individually and collectively affect the pricing of a product.
8. In case of material procurement, right quality does not imply the best quality, but the quality that suits best for the quality of end product planned by the firm.

6.6 SUMMARY

- 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.
- 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).
- Many entrepreneurs do not care to protect their intellectual property. In today's business world, one has to be very conscious and careful in protecting the intellectual properties. Entrepreneurs are expected to be aware of legal issues that surround the business, whether at the start-up phase or during operations.
- 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, 1957and (iv) the Trade Secret.
- 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.
- Marketing is a function over which we can have only an influencing power but hardly any control over the outcome. Therefore, marketing function is very important especially for a new enterprise. The market analysis is done before a business plan is prepared and it is included in the business plan, i.e., at the project phase of a proposed business.

- In marketing the assessment of market in the initial stage, understanding market dynamics throughout the business existence and early achieving the market acceptance are critical for successful start-up and its growth.
- There are several aspects of day-to-day operations. Procurement, storage, production, transportation, inventory holding, sales, collections, maintenance, man-management and several other functions together can make operations possible.

6.7 KEY WORDS

- **Company:** A legal entity separate from its owners and, therefore, the owners are not liable for the company's liabilities.
- **Franchise:** Franchise is an arrangement between a franchisor and a franchisee through which a franchisor gives right to a franchise to use brand name, logo, products, supply chain and almost everything of a franchisor at a fee and subject to monitoring and control.
- **Sole proprietorship:** A form of business organization where the owner has full control over the business and its management.
- **Trademark:** It is 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.
- **Trade secret:** 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.

6.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Explain the different forms of business organizations.
2. What do you mean by franchising?
3. Why is market acceptance important for a business?
4. 'There are legal issues when a new business is started or during its operations.' Explain what these legal issues are about.

Long Answer Questions

1. How can you establish ownership over innovations and contributions?
2. How is a new venture marketed?

6.9 FURTHER READINGS

NOTES

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UNIT 7 MANAGING GROWTH IN NEW VENTURE

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Structure

7.0 INTRODUCTION

In the previous unit, you studied about the different forms of business organizations, the different acts through which intellectual property can be protected and the various assessments to be made for marketing a new venture.

After launching a new business, the focus is shifted to consolidating technology, after that for consolidating marketing efforts and once full capacity utilization has become possible because of booking of orders, attention has to be drawn towards growth. Growth is the best strategy for survival. Therefore, in this unit, we will focus on understanding issues related to growth; meaning of growth, need for growth and factors affecting growth before discussing characteristics of high growth firms. Strategies for growth are discussed after that, where emphasis is on direction of growth and sub-strategies associated with each possible direction.

7.1 OBJECTIVES

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

- Explain the importance of growth for a firm
- Identify the characteristics of a high growth firm
- Describe the strategies for growth
- Assess the significance of human resources for ensuring growth

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7.2 CHARACTERISTICS OF HIGH GROWTH

The growth of a firm had mainly remained a topic for economists to discuss for a long time before Young (1961) wrote, 'The phenomenon of corporate growth – the product of wide range of contributing variables – has fascinated and baffled economists, executives and investors for as long as competitive business organizations have existed'.

What is Growth?

In the world of real business, the term 'growth' is often used, because a competitive environment has compelled business firms to view growth as the best survival strategy that may decide whether a firm will prevail or perish.

Growth of a company is occasionally understood with reference to change in quantity sales, rupee sales, gross or net investment in asset, profit or profitability. The term 'growth' is also used to indicate change in market share or earning per share or market price of share. Stanford Research Institute, an applied research centre in Menlo Park, California, (Young, 1961) had conducted a fundamental study and developed a formula for growth ranking of firms. They had included three growth measures: the percentage increase in sales (growth in size), in net profits, and in the price of the company's common stock (Figure 7.1).

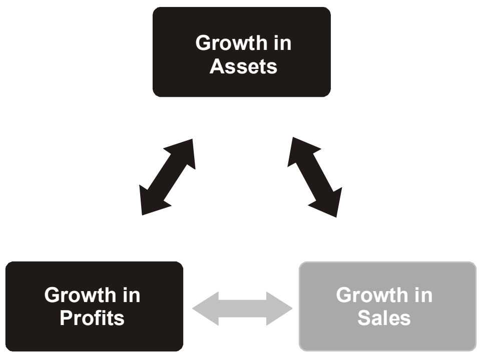

Fig. 7.1 *Firm's Growth Cycle*

In this unit, the growth of a firm has been defined in terms of change in gross block. Gross block means the purchase value of fixed assets; and change in gross block means new investment in the firm's fixed assets. It was observed there that a strong positive correlation existed between the movement in market price of share and change in the gross block of the firms.

Asset growth provides much needed conditions for growth in sales and profit. It must be followed by growth in sales through technological consolidation first and then through market consolidation. Sales growth should lead to profit growth, if the consolidation phase is suitably managed. In turn, the retained profit would create the necessary pre-requisite conditions for the growth in asset. The cycle of firm's growth would, thus, continue.

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Why Should a Firm Grow?

Some firms grow through product-diversification to minimize business risk, and some expand their operations globally to achieve market-line diversification needed for spreading out the risk. Reasons for growth vary from time to time, depending upon the situation. But ultimately value maximization should be the firm's objective.

Factors Inducing Growth

The entrepreneur's attitude towards growth has a tremendous impact on the quality of growth. Quality means sustainability. Sustainability brings out the full potential of the firm for maximizing firm's value.

Demand-push growth is an unplanned growth and is not a sustainable growth. It essentially means just a routine or mechanical response to the opportunity coming on the way of a business firm. The entrepreneur responds to the growth in demand of their product, and invest fresh amount of funds usually in expansion activities. Any change in pattern of demand would change a firm's financial position in a demand-push growth. Proactive growth requires strategic planning. Constant scanning of the environment for opportunities and threats, continuous study of internal strength and weaknesses, and strategies for establishing a viable fit between resources and opportunities are the characteristics of a proactive firm.

7.2.1 Characteristics of a High Growth Firm

Proactive growth is possible with entrepreneurial zeal of managers and owners of a business. The high growth opportunity arises out of four factors (quadrants) combining with each other, namely,

(i) Characteristics of an entrepreneur
(ii) Characteristics of business
(iii) Business practices of the enterprise
(iv) Human resources

Let's discuss each of these characteristics in detail

(i) Characteristics of an entrepreneur

An entrepreneur who possesses the following qualities is likely to steer his/her business towards a high growth trajectory:

- Passion
- Vision to attain dream
- Persistence to work relentlessly and tirelessly
- High Self-efficacy to attain one's objective
- Resource Skills
- Intelligence

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(ii) Characteristics of business

Some characteristics of a firm would be conducive to high growth. Some important ones are as follows:

- Strong commitment for growth
- Collaborative Growth Strategies
- Good Planning Strength
- Vibrant Organization

Figure 7.2 provides stages of evolution and revolution of an organization.

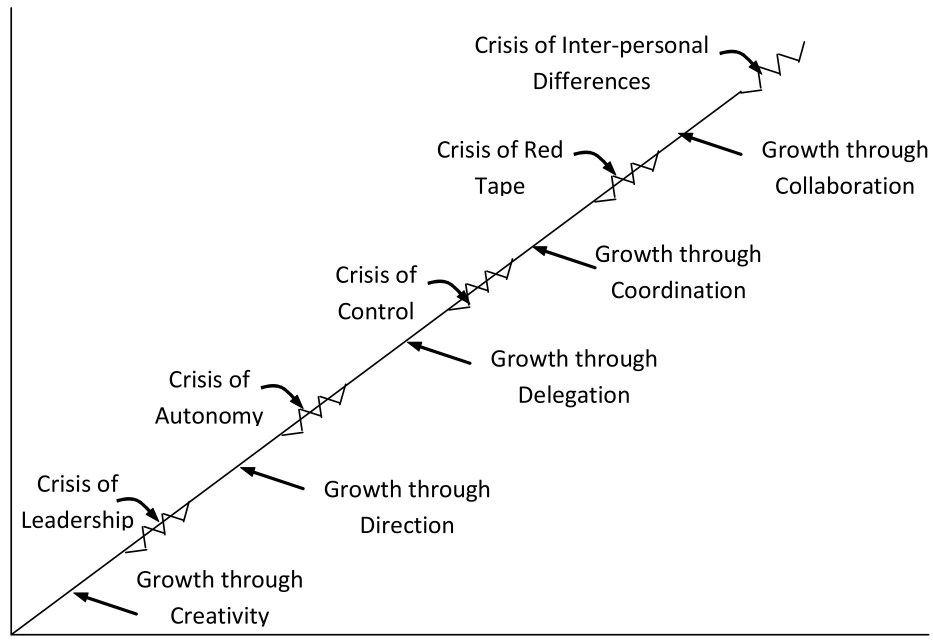

Fig. 7.2 Stages of Evolution and Revolution of an Organization

Usually in the infancy stage, vibrancy is derived from the visionary leader. When employees acquire confidence and understanding of business the further growth of business is ensured by granting little autonomy and guiding behaviour of the leader. But when the crisis of autonomy arises, delegation would become the key for ensuring fast growth. When powers are delegated controls are lost over a time. When that happens, leaders test lies in coordinating skills; if the leaders effectively coordinate efforts of all departments and managers, the growth remains on a good trajectory. However, coordination would require rules and processes, the excess of which would result into red-tap organization. Collaborative spirit may fade away and result into inter-personal crisis. Business is disintegrated at this stage and divisions are spun-off to make them into separate firms, who start from the left-bottom corner of Figure 7.2.

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Reshaping of an organization structure as per the first sign of any type of crisis, supported with a suitable leadership, is very much essential. Otherwise an organization may start losing its effectiveness.

(iii) Business practices of the enterprise

Business practices are important for a long-term play of business, which grows fast. It is matter of rules, procedures, documentation and overall culture that can deliver customer satisfaction and build credibility. This can be achieved through quality product and services, offering of value for money to customers and innovations that may fullfil customer needs.

(iv) Human resources

Human resources are of utmost importance for the survival and growth of a business. It is also true that a growing firm can easily offer opportunities for employees to grow. Growth here does not mean financial advancement, but mostly professional advancement.

Be selective in hiring employees, especially on key positions. Search for the right people and offer opportunities in monetary terms and growth terms. Hiring is one thing and developing is another. Continuous development of human resources is a function of several well-designed actions like, compensation plan, motivational steps, training need identification, imparting training, bringing innovation in jobs, empowerment of employees, promotion opportunities and others. Employee commitment is commanded through positive culture and empowering leadership. Still, recognition in monetary terms cannot be undermined. Start-ups are well-off designing reward system that attracts talent that is willing to take risk and be rewarded if risk taking succeeds. High growth rate of an enterprise is a compounded outcome of several factors characterized by entrepreneurship characteristics, business characteristics, business practices and human resources. Interplay among all these collectively creates an environment that may be either conducive to growth or destructive to growth.

Check Your Progress

1. What should asset growth be followed by?
2. Which type of growth is not a sustainable growth?
3. What is continuous development of human resources a function of?

7.3 STRATEGIES FOR GROWTH

The issue of growth is strategic in nature, therefore, it involve strategic thinking, and hence, application of SWOT analysis. A SWOT analysis model must suit the need for answering a particular question, which is related to either direction of growth or rate of growth or strategy for growth. Strategic models are described and their applications are explained in each of these fields of strategic decisions in the following sections of this unit.

7.3.1 Growth Direction Decision

Synergy is the measure of an effect on the net benefits of combining more than one activity. Synergy is said to exist when the whole is greater than the sum of the parts. The presence of some strength and its best fit with available opportunities are essential for creating a positive synergy. For the growth direction issue the synergy is searched in the areas of product and market. A SWOT analysis on these two parameters can give a quick idea about the value creating growth alternatives. A product-market matrix is given in Figure 7.3.

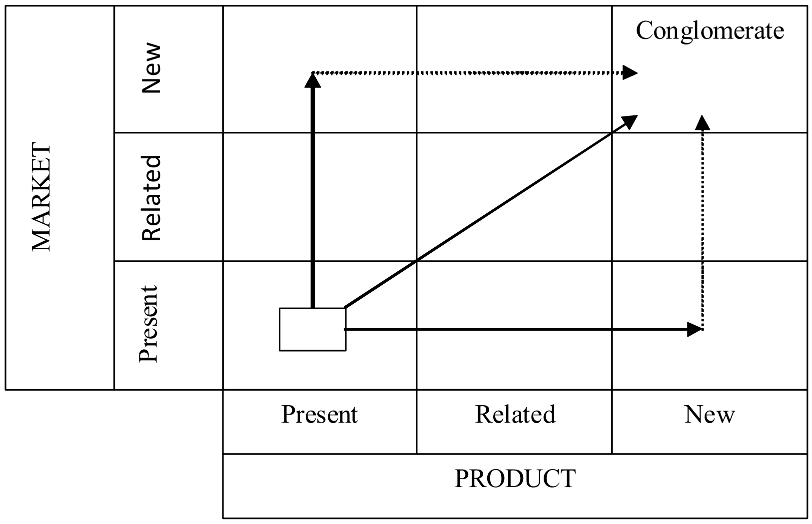

Fig. 7.3 *Product - Market Matrix*

Both the sides of matrix given in Figure 7.3 are divided into three parts each; on product side, present product, related product and new product; and on market side present market, related market and new market. Present market is one that is initially defined by the firm. Geographic boundary, age group, income group, among others could have been defined in the identification of market segment. Related market indicates that the segment is new but not absolutely unfamiliar to the firm. An overlapping area of the present market and new market is termed as related market.

Four possible directions of investments can be charted on the basis of product-market analysis: (i) grow where you are, (ii) market side (vertical) growth, (iii) product-side (horizontal) growth, and (iv) diagonal growth. Let's discuss each of these directions in detail.

(i) Grow where you are

If a firm is in a position to meet its growth and profit requirements in the present market and with the present product, it would not see any need to change direction.

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The firm would continue to be in the same business and the same market. Familiarity with the product and the market is a comfortable position in managing growth and profitability. The following options are available for growth without change in direction.

- Expansion
- Modernization
- Backward integration
- Cost effectiveness
- PLC based strategies: Each product pass through four phases during its life cycle, which is called as a product life cycle (PLC). The four stages include introduction, growth, maturity and decline. Several of these strategies are operational strategies and some long-term ones. Figure 7.4 gives the PLC and corresponding profitability and cash flow generation capacity of the product.

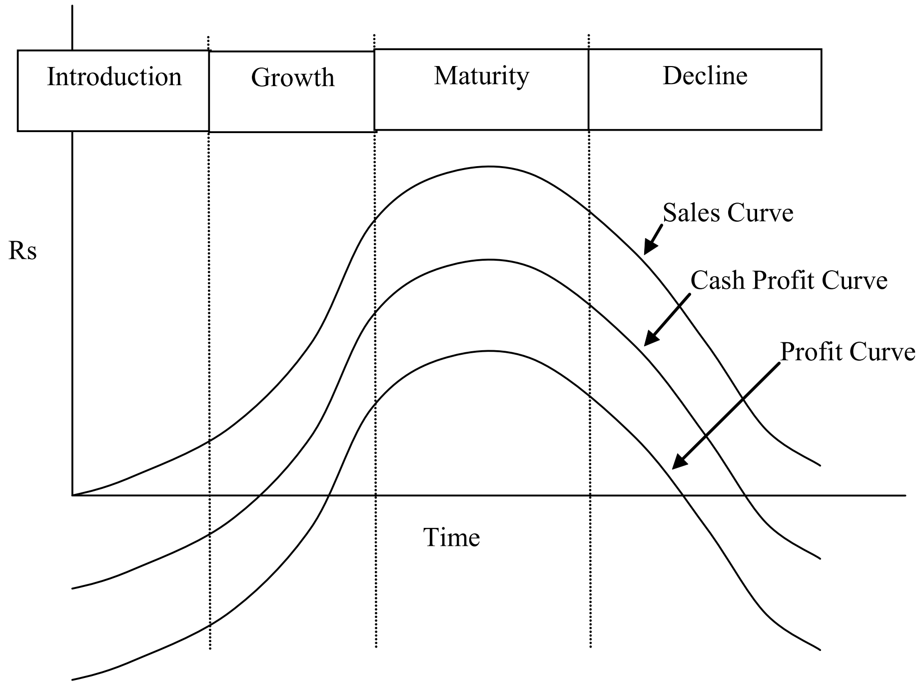

Fig. 7.4 *Product Life Cycle*

(ii) Market side growth

A firm, which is weak on product side but strong on marketing, would not prefer to venture into related or new products. It would rather prefer to expand its market. Strategies based on product life cycle were seen earlier. The maturity stage can change the growth direction, if the firm is willing to enter into related and new markets. The GE matrix given in Figure 7.5 and other such marketing models explain where and how to push up sales of the present product.

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Industry attractiveness

Company position and strength

premium invest/Grow	Selective invest/Grow	Protective selectivity/Earnings	High
Challenge invest/Grow	Prime selectivity/Earnings	Restructure Harvest/Divest	Medium
Opportunistic selectivity/Earnings	Opportunistic Harvest/Divest	Harvest/Divest	Low
High	Medium	Low	

Fig. 7.5 *GE Matrix*

A firm, which possesses a better market strength, but whose present market offers insufficient opportunities, may capture related and new markets. Initially market penetration and later on market development may be desirable. The firm, after capturing the market, has to consolidate in terms of acquiring product strength. This implies that after going initially in the vertical direction in the product-market matrix, the firm has to change its direction and go horizontal. The firm has to set up R&D facility, improve quality, cut down costs and add related products. This pursuit finally results in the concentric diversification.

(iii) Product side growth

A single product in a product-portfolio ties firm's cash flow and profits with the phases of the product life cycle. The BCG matrix, therefore, advocates systematic building of a product-portfolio so that a firm can achieve a smooth flow of cash and profits. To achieve this goal a firm has to ensure that at any point of time it has different products in different phases of life so that it can use cash flow from cash cows and invest in a new (question mark) product and also re-invest some cash flows in the star products instead of allowing cash cows to consume its cash flow or permitting dogs to eat up cash flows and profits.

A firm possessing significant strength related to its product but which is weak in marketing would see its product maturing fast. This firm should naturally prefer to add first related and then new products in its product portfolio. These related and new products must have an appeal to the firm's current market for the present product. Product quality, efficient research and development work, effective workmanship, low cost but high value products, etc., indicate product strength. A firm may gradually enter into a new product, which may have only a distant relationship with the original product in the product portfolio, but it can be offered to the existing market.

Product side growth can only continue up to a point, beyond that the vertical direction (market side growth) may become a necessity. The BCG matrix given in Figure 7.6 explains the need and timing for adding new product. Question mark

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products (products in the introduction stage) are cash hungry. They need support. Star products (products in the growth phase) are almost self-sustaining. They generate enough cash required for ploughing back into them. Cash cow products (products in maturity stage) generate a lot of surplus funds, which need not be fed back to them. Finally, dog products (products in decline stage) need to be divested; sold if they are in the early dog stage, or harvested (salvaged) if in the late dog stage. Harvesting or divesting generates funds. Operating funds, generated by cash cows, and terminal cash flows generated by sale or salvaging of dogs, should be invested in some opportunities. If a firm has no or only a few question mark products in its portfolio, then it would turn into a cash rich company. A persisting cash rich position is bad, as it is an indication that the company has no profitable plans of investment. The excess funds need to be deployed for growth. Product-line growth (introducing a new question mark product) is the right choice in this case.

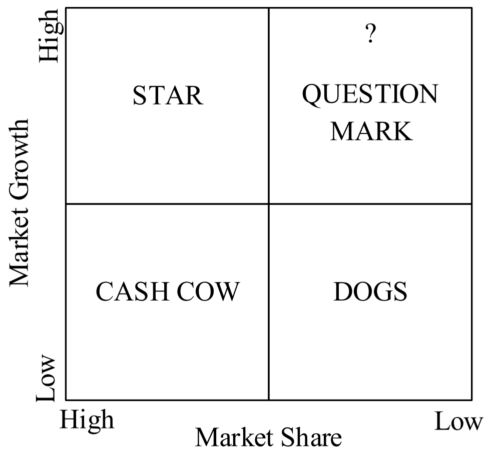

Fig. 7.6 *The BCG Matrix*

However, a firm should not introduce too many new/related products at the same time. It may find shortage of funds if an unmanageable number of new products are introduced. A pursuit of a balanced product portfolio, thus, makes it imperative on the part of a company to periodically introduce related or new products in the market.

Tata Engineering and Locomotives Company Limited (TELCO, now Tata Motors) is a good example of product-side growth. It remained in the present-market present-product cell for a long time with heavy commercial vehicles in its product range. Tata Motors had built excellent product strength in terms of R&D and road-worthiness. As a result, it changed the direction to enter into light commercial vehicles (LCV) market, which was a product side growth, when it saw the sign of competition and found better appetite for growth. Though it was a late entrant in LCV market, it easily became the market leader. The process

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of market side growth continued till utility van was introduced in the market. The introduction of utility vehicle in its product-portfolio was the declaration to enter into the passenger car market. It did enter the passenger can market through the slightly upper market segment and later went into the lower end of the market. The firm spent a lot on corporate and product advertisements, before entering into the passenger car business. They built strength, which they did not possess earlier, because now they were changing direction upwards in the product-market matrix.

(iv) Diagonal growth

Only a few companies can think of successfully growing into the diagonal growth, because it is like riding two horses at a time. One needs to be strong on both the product and market fronts, which is often not the case. However, firms with very ambitious growth plan can look forward for sharing strengths with other firms and move into the diagonal direction. The strategies for diagonal growth may be many memorandum of understanding, joint venture, takeovers and mergers. Business alliances are made with suitable partners so that the diagonal growth could be fostered jointly by sharing resources. Strategic intents of business alliance should go beyond just sharing resources and each partner should build strength from the other partner's presence, especially if it is not a merger with another firm. The business alliances are usually short-lived.

Two points need special mention here. One, firms must initially exploit their strength as they gives highest synergetic value. Also they must remove weaknesses and start building strengths in other fields, much before the further change in direction is warranted. Two, each firm carries two inherent contrasting behaviours. The familiar environment of the product and market in which the firm is presently functioning is the most comfortable area of functioning as long as the thirst for growth is satisfied. Firms therefore change direction. Right timing for change in the direction and preparation for the change are essential. Ultimately, over a period a firm becomes a multi-product multi-segment conglomerate firm. A conglomerate firm could hardly grow faster and can face more problems associated with inter-personal conflicts (Greiner, 1972) among division heads causing damage to the common cause in the pursuit of maximizing division's benefits. Therefore, when a conglomerate firm starts facing crisis of inter-personal conflict it must go back to present-product-present-market cell to create conditions for further growth. Spin-off is one way of the restructuring exercise for achieving this target. In a spin-off, technically each division or a group of divisions comes into existence as a new firm and cycle of growth continues for each one of them but now separately and independent from each other. A non-synergic haphazard growth is difficult to manage or sustain, as it may become a risky preposition.

7.3.2 Growth Rate Decision

At what rate should a company grow? A minimum rate of growth should be equal to inflation, the economy growth rate or the industry growth rate, for some. Others may set target looking at competitors and try to achieve a growth rate at last equal to the competitor.

Benchmarking of growth rate in terms of inflation rate, industry growth or economy growth could be at the most a minimum target. Only those firms will view these as the ideal growth rate, who go for demand-push growth, and do not consider the growth rate as a decision variable. They are unlikely to go through a steady growth period as the market decides their growth. They are also unlikely to sustain the growth rate. Proactive firms would like to decide sustainable growth rate for them. Sustainable growth rate is determined by a combination of two sets of factors: one, financial factors and two, organizational or managerial factors. A firm, which has learned the art of managing both these factors, can look forward to fulfilling the ambitious goal of a super-growth.

'Profit determines growth' is the premise behind financial considerations of sustainable growth rate. 'Growth determines profit' is the premise around which organizational theories are developed to explain the ability to manage growth. Thus, we have two models of sustainable growth rate: a profit-constraint model and a managerial constraint model.

7.3.3 Growth Strategies

After deciding about the growth direction and growth rate the planners must select the right growth strategy. Growth strategy is a vehicle, which takes a company to a targeted destination (direction) and within the target time (at the targeted speed). This is done in two stages: the choice of internal vs external growth, and the choice of growth alternative.

Internal vs external growth

A company is said to have opted for internal growth if it makes fresh investment in the desired field. Expansion, modernization, replacement or any other green-field projects bring internal growth. Whereas external growth is achieved either through buying out of an existing firm or through some arrangements with other firms, which may fit well in growth requirement. Merger, acquisition, takeover, joint ventures, collaboration, and strategic alliance are examples of external growth. A firm's internal strength must be assessed before taking a policy decision in favour of either internal growth or external growth. Some firms are very good at managing external growth, while others possess strength of managing internal growth. Internal growth requires strong project management skills and advance planning (because of gestation period), whereas external growth requires skills of managing various stakeholders on both sides as well as ability to manage cultural transformation, though it may offer instantaneous growth. Some argue that firms who opt for high growth rate select external growth option. It is not a necessary requirement. Reliance Industries has demonstrated superb internal growth. Choice should be based on assessment of the organization's capabilities.

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Growth alternatives

There are many growth alternatives to choose from. Among them are expansion, capacity enhancement, modernization, technology upgradation, divestment, concentric or conglomerate diversification, consolidation, spin-off, market penetration, market development, backward and forward integration, horizontal integration and so on. A suitable strategy must be selected in the light of strategic decisions on the growth rate and the growth direction.

7.4 BUILDING THE NEW VENTURE HUMAN CAPITAL

In this section we will highlight on building a new venture human capital.

7.4.1 Important Aspects of Human Management

Selecting high performing employees shall always be a priority of an enterprise, even if it costs more. One has to search for such employees rather than inviting application and going through a selection process. Head-hunting agencies can be employed for this purpose.

Bringing in professionalism is another important challenge for an entrepreneur. Lack of professionalism may still allow a family to continue in business but may not allow strategic growth of a firm. Unprofessional firms may not be in a position to attract good talent and retain them. Professionalism involves empowerment of key employees and allowing them freedom to take decision and be responsible for the same.

Increasing motivation and commitment of employees is a serious task an entrepreneur has to perform. One has to invest time and money in keeping the employees motivated. Though empowerment and reward system are essential parts for motivating people and in soliciting commitment, the continuous growth of employees in the firm is equally important.

Retaining employees seems to have become a difficult task with increasing mobility of people. However, well-motivated and committed employees who work in a professional environment are more likely to stay for a longer period with the firm.

Managing conflicts is yet another task in man-management. Where there are more people, committed people and highly motivated to perform the chance of conflict among them is also high. Different priorities demanded by the job, different temperaments, lack of appreciation for each other's role and absence of business savvy character can cause conflicts. A leader has to constantly invest time in conflict resolution in an amicable manner.

7.4.2 Managerial Slack and Growth Requirement

For a growing enterprise, timely creation of slack and using it for productive purpose could be a great and good strategy for not only growth but also for retention. The organization also has to grow along with the issues associated with growth. The following text explains the managerial slack and its utilization for retention of employees and growth of the firm, as well as the organizational growth.

(i) Managerial slack

The term 'managerial slack' as defined by American economists R.M. Cyert and J.G. March (1963) is also called organizational slack. In very simple terms, organizational slack is achieved when managers are able to complete their routine task within working hours and are still left with some spare time for doing important work for business. Staffing and internal processes collectively determine the organizational slack. A negative slack, where time required for completing work is more than the working hours would make people attend to only urgent work; important work and the quality of work would be neglected.

(ii) Organizational development

The development of the organization is a continuous process. The degree of centralization, style of leadership, processes and host of other factors should assume different shapes to suit the stage of organizational development. Professor Larry Greiner (1972) described the stages over which an organization would grow, and face changing problems. These stages are depicted in Figure 7.2 on the evolution and revolution of the organization. An enterprise that manages various nodes on the evolution and revolution chart by suitably adjusting the leadership style, organizational structure and processes stand to grow faster.

Check Your Progress

4. What is synergy?
5. Mention the four stages of a product life cycle.
6. What are the factors which indicate product strength?
7. List some of the strategies for diagonal growth.
8. What does professionalism in human management involve?

7.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Asset growth provides much needed conditions for growth in sales and profit. It must be followed by growth in sales through technological consolidation first and then through market consolidation.

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2. Demand-push growth is an unplanned growth and is not a sustainable growth. It essentially means just a routine or mechanical response to the opportunity coming on the way of a business firm.
3. Continuous development of human resources is a function of several well-designed actions like, compensation plan, motivational steps, training need identification, imparting training, bringing innovation in jobs, empowerment of employees, promotion opportunities and others.
4. Synergy is the measure of an effect on the net benefits of combining more than one activity. Synergy is said to exist when the whole is greater than the sum of the parts. The presence of some strength and its best fit with available opportunities are essential for creating a positive synergy.
5. The four stages of a product life cycle include introduction, growth, maturity and decline.
6. Product quality, efficient research and development work, effective workmanship, low cost but high value products, etc., indicate product strength.
7. The strategies for diagonal growth may be many: memorandum of understanding, joint venture, takeovers and mergers.
8. Professionalism in human management involves empowerment of key employees and allowing them freedom to take decision and be responsible for the same.

7.6 SUMMARY

- Starting a venture is easy but nurturing it for growth is more challenging because there is only one way of survival, and that is through growth. Growth comes in phases, first investment in business grows, and then it shall result in growth in sales, and then profit and again growth in investment. The cycle begins with investment growth made in a very strategic way.
- If a venture does not grow in the right direction chances of earning profits or improving market share may reduce. The choice of growth direction can be made by the application of product-market matrix in which strengths and weaknesses around product and markets of the existing business are assessed and trajectory is decided where the growth lies.
- The application of product-market matrix gives many options for the growth direction. Based on the one chosen with the application of this model, further applications of product life cycle, BCG, GE models would give further clarity about the area where focus must be laid for growth.
- The next question is about the rate of growth. Slower or faster growth rate would bring sub-optimal results and sometimes even negative results.

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- Another important decision area is how to grow, that is growth strategies. Growth strategies are broadly divided into two parts, internal growth and external growth. Internal growth is more organic and that comes with green-field projects wherein a firm starts a new project afresh and takes a risk of gestation period and associated risks. In external growth strategies mergers and acquisitions or other types of collaborative growth are included.
- A well-chosen growth path, growth rate and growth strategy will work only if proper human resource management as well as appropriate organizational systems are in place.

7.7 KEY WORDS

- **BCG matrix:** The BCG matrix arranges all products of a firm on market share and market growth basis and identifies 'question mark', 'star', 'cash cow' and 'dogs' products for strategizing on funds allocation as well as for new product development. It is known as BCG Matrix because it is given by Boston Consulting Group.
- **Growth direction:** Growth direction is an important choice for growth, which is derived from an understanding of the product-market matrix.
- **Growth strategies:** Strategies for growth tells the firm how to achieve the growth direction and growth rate goals; whether through internal growth or external. External growth comes through mergers and other types of alliances, whereas internal growth comes through Greenfield projects. Both strategies require different strengths to make them work.
- **Managerial slack:** Managerial slack is in simple words, extra time that managers may have on hand for attending to important tasks of the firm. This is also known as organizational slack.
- **Organizational development:** Organization system has to keep evolving as it grows in size and age, and as it encounters different crisis situation that come along with the growth. It means changes in leadership style, degree of delegation, processes, among others.
- **Product life cycle:** Product life cycle (PLC) is a model for determining strategies associated to a product through various stages of a product during its life cycle.
- **Product-market matrix:** Product-market matrix is the depiction of strength and weaknesses of a firm against two important parameters, one product and two markets. The comparison of strengths around these two parameters allows the firm to determine its growth direction that is more likely to create synergy and offer safer route for the growth.

7.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short Answer Questions

1. Define the term growth.
2. What are the factors inducing growth?
3. Identify the important aspects of human management.
4. What do you understand by managerial slack and growth requirement?

Long Answer Questions

1. What are the characteristics of a high growth firm?
2. What are the strategies for growth?

7.9 FURTHER READINGS

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UNIT 8 BUSINESS IDEAS

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Structure

8.0 INTRODUCTION

Business ideas may be defined as the attractive project ideas which an entrepreneur accepts as the basis for his investment decision.

This unit teaches you how to generate and select business ideas. It also teaches you the classification of projects, market assessment and the criteria for selecting a project.

8.1 UNIT OBJECTIVES

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

- Understand how to generate business ideas, identify projects and formulate projects
- Know how to classify projects
- Learn how to perform feasibility studies
- Analyse the project appraisal methods

8.2 BUSINESS IDEAS: PROJECT IDENTIFICATION AND FORMULATION

What are the motivational factors that drive an entrepreneur to launch a business? For example, Jemini Tooth Powder is the idea of a woman who, frustrated with existing tooth cleaning items, launched a new tooth powder of her own. There are many such incidents and issues which are directly connected with an entrepreneur's frustrations with existing products or services. These have propelled them to launch successful enterprises.

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Business opportunity may be defined as an attractive project idea which an entrepreneur accepts as the basis for his investment decision. A business opportunity has two major ingredients.

1. Growing markets
2. Optimum return on investment

The entrepreneur has to prepare a list of project ideas identified from various sources. The business opportunities are evaluated against a set of specific criteria to select those projects which are commercially viable.

You have already learnt the methods of generating ideas in Unit 3.

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.

Business opportunity identification and 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 wee 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 opportunities. The observation may be made during the course of one's routine occupation or otherwise.

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Similarly, containerized shipping and sea vans emerged as a result of lack of low-cost global freight coupled with the necessity for prompt on-shore handling. According to Peter Drucker, prior to the evolution of container systems, American shipping had been close to disintegrating. Although cargo ships were not inefficient, the entire shipping system was not very profitable given that the actual transoceanic transport did not incur the high cost that dockside handling and storage incurred. Simple metal containers would result in integrated systems of storing and moving cargo on trucks, railcars and ships. A similar case in point is the plastic templates that are slipped over computer keyboards that enable quick reference to keyboard functions. Such a template provides the user of the compute information at the fingertips on the functions performed by the various keys for the different software applications. Such opportunity gaps provide useful knowledge. A number of exciting applications have been created by software developers such as computer sided designing and word processing. However, it becomes slightly difficult for new users to learn how to use the application as they have to wade through huge manuals written by engineers. This task is made easier by the plastic templates as they make systems more user 'friendly', and at the same time are not very expensive to manufacture because they are actually only printed plastic sheets.

Identifying and evaluating opportunities are not easy tasks. The majority of good business opportunities do not emerge suddenly out of the blue; they are actually a consequence of an entrepreneur being alert to the possibilities that might arise, and in a few instances, the consequence of establishing some mechanism for identifying prospective opportunities. For instance, at all the cocktail parties that they attend, entrepreneurs ask the guests whether there were any people using products that did not quite satisfy the purpose they were meant for. They continuously look for needs and corresponding opportunities for creating better products. Similarly, some other entrepreneurs constantly monitor the toys and recreational habits of their nephews and nieces and come up with some unique toys or some new ventures for the same.

Though the majority of entrepreneurs lack a formal mechanism that identifies business opportunities, certain sources usually prove to be more useful than others,

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such as technical people, members of distribution systems and business associates. Quite frequently, consumers prove to be the best source of ideas for novel ventures. A casual comment such as 'If only there was a product that would…..' can result in a novel business idea. The manner in which a certain entrepreneur evaluates the reason behind the complaints of numerous business executives regarding inadequate word processing and technical writing skills can result in a novel business venture being established for fulfilling this lack. Product needs can be identified effectively by the distribution channel members, because of their close contact with end users of the product. For example, a college bookstore was started by an entrepreneur following his evaluating of students' complaints that the books available at the existing college bookstore were highly priced and the service itself was not up to the mark. Numerous business opportunities have been recognized by entrepreneurs following discussions with wholesalers, retailers and representatives of manufacturers.

Business opportunities are frequently conceptualized by people with technical orientation while they work on other assignments; for example, the one entrepreneur observed the application of a plastic resin compound casket molding and came up with the idea of applying the same to the development and manufacture of certain types of pallets.

Criteria for selecting a Particular Business Opportunity

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.

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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 condition underlying this market need?
- What market research data needs to be marshaled for describing this market need?

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- 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?

8.2.1 Classification of Projects

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 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 : ≥ ₹ 50 lakh 2. Minor Scheme : < ₹ 50 lakh 3. Equipment and Furniture Scheme : ≤ ₹ 0.3 lakh REVENUE SCHEME Repair and Maintenance : No ceiling	1. Replacement 2. Addition/augmentation of production 3. Maintenance facility and services 4. Housing, welfare and amenities, etc.

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.

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8.3 PROJECT FEASIBILITY STUDY

Feasibility studies are exercises in which the potential solutions of business opportunities or problems are documented. They may be undertaken by all types of businesses, teams or projects. They form a crucial segment of the project life cycle. You have already learnt about the concept in Unit 4. Let's recapituate and develop the concept a bit more in this section.

When should a feasibility study be used?

The objective behind the feasibility study is the identification of the probability of one or more solutions that meet the specified business needs. That is, when there is uncertainty about the desired outcome being delivered by the proposed solution, some clarification can be achieved through a feasibility study. When a feasibility study is conducted, several types of 'assessment' techniques are used. Whatever solution emerges at the end of the study is deemed the confirmed solution that must be implemented.

Stages of a feasibility study

Nowadays, private consultancies are doing feasibility studies on different types of project works following a systematic procedure. Generally they divide the feasibility study into four stages. At each stage a report is generated which is shown and explained to the client. Thereafter permission is sought to proceed to the next stage. The stages of a Feasibility Study in normal course of action are:

1. Conceptual stage
2. Elaboration stage
3. Construction stage
4. Implementation stage

Conceptual stage

In this initial stage, an analysis of the business requirements of the client is performed: details regarding those participating in the project and system requirements are gathered and examined. A study of what the client expects with regard to system implementation is carried out and a solution presented. The restraints, parameters and goals of the project such as conceptual problem solution, time frame for the project and the budget for the project and policies regarding adjusting it are established with the client.

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The following tasks are performed at this stage:

- Estimation of the feasibility of the project and defining its scope
- Identification of the benefits and risks
- Elaboration of the structure of the project
- Planning the project roughly
- Accurately planning the next stage of the project stage
- Precise evaluation of the cost involved in the next phase and approximate evaluation of the cost involved in the other phases
- Definition of functionality development priorities
- Estimation of system creation risks

The following documents become available when this phase concludes:

- Feasibility Report — describes the solution that is proposed and lists the high-level functional requirements
- Project Structure — describes the organization of the project
- Project Plan — gives the project schedule
- Risks List — lists the potential risks associated with the project and the possibility of eliminating them

The client must agree with and sign the feasibility report. Once it is signed, then the project team and the client share the understanding of the tasks and goals and can agree on the process to be followed for implementing the project. On an average, it takes roughly ten per cent of the total duration of the project for this phase to be completed.

Elaboration stage

Here, the following tasks are performed by the project team:

- Analysis of the needs and expectations of the client with regard to the development system
- Definition of functionality of the main components of the system and the composition and architecture of the system
- Designing of the system on the basis of the outcomes of the analysis
- Establishment of the accuracy of the timing

The documents that are created during this stage include the following:

- Functional Specification — describes the functionality and architecture of the system as well as the logical data models
- Configuration Management Plan — describes the structure of the storage of project files as well as the rules for building the system

The client must agree with and sign the functional specification. Once it is signed, the project team and the client agree about the following:

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- Providing a solution to the problem faced by the client with regard to project parameters (project restrictions)
- Comprehending the risks associated with the project and sharing it with the customer
- Project plan (time, cost and functionality)

On the basis of the requirements of the customer, there may be some variation in the name of the document (such as Requirements Specification or System Requirements Specification). Following the preparation of all the above documents, the next step is the creation of the Test Plan, which gives a description of the testing procedures to be followed for the project. Consequent on this stage, an absolutely documented solution is presented to the client, which he can then develop into an entirely functional system, in time and keeping within the budget that has been allocated to it. When this phase concludes, the client is provided with a rather accurate assessment of the time and cost involved in implementing the project. On an average, it takes roughly thirty per cent of the total duration of the project for this phase to be completed.

Construction stage

Here, the system requirements are determined by the project team (in case they were not determined in the earlier phase) and the system is developed on the basis of the outcome of the analysis and design carried out in the preceding phase.

The tasks that are preformed at this stage are as follows:

- Defining the requirements of the system iteratively on the basis of the outcome of development
- Coding the components of the system
- Integrating the components of the system
- Testing the system
- Managing the risk associated with the project
- Updating the project documentation (if there is some variation in the requirements)
- Preparing technical and user documentation

Simultaneously with any advances in the coding, the creation and upgradation of the Technical Specification also takes place. Detailed descriptions of the architecture of the system are contained in it. The primary object of this stage is the completion, delivery and installation of a full-scale operational application in the real working environment of the client so that it can be adjusted, set up and configured on the customer's hardware. The completion of coding and integration is followed by the commencement of the process of testing. The Test Specification is created in advance. Once the development and testing of the system concludes, the next step is the development of the plan for implementing the system at the client's location. The following details are contained in this document:

- Implementation timing
- The schedule and list of the tasks to be performed during implementation
- The resources that would be required
- The job responsibilities to be implemented

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On an average, it takes roughly fifty per cent of the total duration of the project for this phase to be completed.

Implementation

In this stage, the system that has been developed is delivered to the client by the project team. Numerous iterations may be contained in this phase, including user acceptance testing and system modification on the basis of the feedback received from the user after testing. A Letter of Acceptance is signed by the client following acceptance testing. The following tasks are performed during this phase:

- Installing the system at the client's location
- Integrating the system in keeping with the client's technology
- Configuring the system
- Training the users

When this stage concludes, a reliable application that corresponds to the functional specification is received by the client. In case at the conclusion of the implementation stage (and the project itself) the system functionality needs to be expanded, it is possible to enhance the system within the framework of a new project. A functional version of the system is received by the customer even as iterative system development proceeds and functionality is added to the existing system. On an average, it takes roughly ten per cent of the total duration of the project for this phase to be completed. The client arrives at at a decision about closing the project after the successful completion of this stage.

With the completion of all the four stages, the client has benefited from the feasibility study and has been able to make the project reality. This is a multipurpose activity taken up by private consultancies for mutual benefit.

The areas of feasibility study has already been discussed in Unit 4.

Check Your Progress

1. What are complementary opportunities?
2. Why is the evaluating a business opportunity perhaps the most crucial aspect of the entrepreneurial process?
3. State the average time it takes for the conceptual stage to be completed in the total duration of the project.
4. List the tasks which are performed during the implementation stage of a feasibility study.

8.4 PROJECT APPRAISAL METHODS

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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.

8.4.1 Project Design

Presumably, the plan for the project specifies the end product that is desired and in some cases it may contain considerable details about the components that make the end product. Such information provides the basis for constructing work packages and specifying their contents. In many cases, however, the nature of the work packages cannot be determined simply from the specifications for the end product and engineers must develop a concrete plan, perhaps working backward from the end product first to its components and then to the activities that are required in order to obtain such a component. This process finally culminates in a detailed engineering design and erection plan.

The technical aspects of work packages or activities are manifested in engineering design for each discrete activity and the plan for step-by-step erection of the whole sub-unit and plant or building. The stage of engineering design and erection takes the engineers into full depth through dissecting each technical work into minute details and steps. The engineering design would detail all specifications like size, shape, thickness, alloy characteristics and properties and functionalities of every piece included in a machine or equipment and their sub-parts. Erection plan is a step-by-step process of putting all pieces together with the stages of testing and experimentations. The actual idea of time needed for completing an activity and interdependence of a given activity with other activities and cost of activities becomes clear only after the engineering design and the erection plan is prepared. We can call this aspect as the quality and technical performance aspect of the project.

Equipment supply

Projects involve significant investments in machines and equipment. They may be either the core assets for the project or the support assets. The capacity of each machine, the balancing of equipment and the technical specifications are very important in the purchase of machines and equipment. More often than not, machines and equipment have to be fabricated as per specifications. Specialist

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fabricators with excellent track record and transportation of fabricated machines either in full or in knock-down condition, together with cost are the issues of greater concerns in the planning of equipment supply. Equipment needed for activities on critical path has to get better attention and close follow-up from the procurement team. Contracts with fabricators are the main driving factors in the successful acquisition of machines and equipment.

Material procurement

Project construction involves procurement of thousands of special material that the business would not keep for its routine activities. Vendors may be unknown and their reliability uncertain. A procurement team has to develop vendors for various material items and buy the resources as and when needed.

Each activity planned in the network analysis, together with the start date and the progress plan until the finish, would set a benchmark for ensuring material availability. Material cannot be bought too much ahead of time because of limited and unsafe storage (usually a make-shift) facility. The material procurement plan has to emerge from a well-planned network after slack management and crashing plans.

Manpower planning

Manpower with different skills and experience would be in demand at different times of project construction. Some scarce manpower would raise the issue of its allocation, which would have a bearing on the project activities' start and end dates. If the firm is drawing some or all manpower resources for routine business operations, then coordination with operations would be an added challenge. A smooth flow of required manpower from one activity to another (especially when they run parallel) and between project activity and routine operations without causing the conflict of priority of different activities cannot be easy to ensure.

Budgeting

Project budget has two components in it, cost and cash. Every resource consumed has a cost and cash flow effect. Cash flow has to be tracked with time and cost with activities. Cash flow budget is required for liquidity planning and for obtaining funds in time. Cost of activities is helpful in exercising control over project construction. Cost and cash flow budgets emerge from resource planning and contracting. A budget offer has to work in close coordination with the technical staff who prepare project network and with the procurement officers.

(i) ***PERT-cost***

Project budgeting can improve with the PERT-cost. The technique called PERT-cost attempts to incorporate a cost dimension along with time dimension into the network analysis. This is basically an extension of the approach to planning the time dimension. This helps in developing a critical path that is optimum considering both the time and the cost aspects jointly for planning purposes, as it is supposed to provide cost-time trade-off. For control purposes, it is supposed to provide a basis for analysing actual times and actual costs jointly. It also helps in determining the cash flow requirement during the course of the project.

Experience has shown that PERT-cost is so complicated that it often loses practical application. In order to control time, the work packages must be quite small but difficulty is experienced in estimating the cost of each small work package.

(ii) Bell curve

If the budgeted cost and the cash flow, prepared in conjunction with the network and the resource plans, are depicted on a chart over the timeline (or activities on critical path), one of the two common patterns is likely to appear. It would be either a bell curve or an s-curve. The costs (or cash flow) depicted over the timeline is likely to be a bell curve as shown in Figure 8.1.

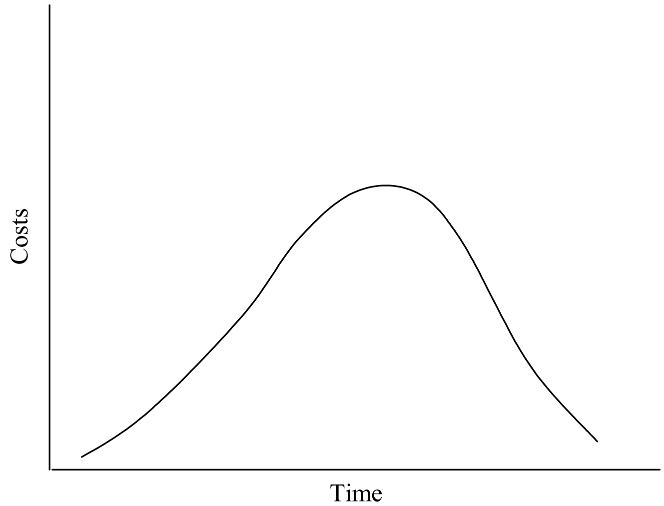

Fig. 8.1 *Bell Curve of Costs over Time*

The goal of the procurement officer should be to either flatten the bell curve or to make it slowly rising towards the end, like a hockey stick. That will save costs in terms of time value of money. The bell curve can be adjusted by reviewing slacks and determining late start and late finish of activity together with crashing of activities.

(iii) S-Curve

The project costs accumulated over time would show s-curve shape as depicted in Figure 8.2. S-curve initially rises slowly, followed by a steep rise and then tapers down. This is a result of bell shaped periodic expenses on project construction.

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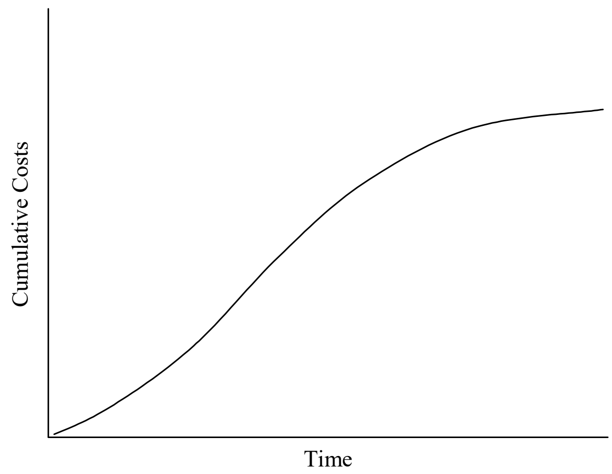

Fig. 8.2 *S-Curve of Cumulative Costs over Time*

The goal should be to achieve the rising part of the s-curve as late in the project construction as possible to help minimize the opportunity costs. This again emphasizes on the network design and the coordination among technical staff and procurement staff.

Detailed project report is a project implementation guide for the project team. Details are so many that more often than not, a detailed project will be prepared in several large volumes. The contents of a detailed project report will include some major information such as the following:

1. Activity schedule (network diagram), with critical path and slacks
    a. Master network
    b. Functional network
    c. Schedule of work packages (along with that of contractors)
2. Detailed engineering design and erection plan
3. Resource consumption plan and procurement plan with timing
    a. Machine fabrication, potential suppliers (or selected suppliers) and transportation of fabricated machines and equipment
    b. Material procurement schedule along with suppliers identified or contracted
    c. Manpower planning
4. Costs, with breakdown with respect to time and progress of work packages.
5. Organizational structure with all subproject teams, their powers, responsibilities and relationships with other units
6. Data collection and reporting methods, frequency and the system
7. Contingency plans and potential response cycle, especially for activities on critical path

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Thus, a detailed project report is a complete blueprint for the execution of the project. It is the project implementation guide for the project team. It describes functions, authority and activities along the line of time, cost and technical parameters. DPR sets the standards for time, cost and work with which results can be later compared as and when the work progresses.

8.4.2 Network Analysis

A number of activities with a great degree of variety and interdependence require the firm to organize the activities in the best planned way to avoid any confusion and complications in the execution of the project. A systematic approach in planning the activities would include several steps and decisions. First, the firm has to decide whether they would want multi-level scheduling and multi-project scheduling or not. Then, the activities must be identified discretely, the time for each activity must be estimated, the resource requirement must be planned and the interdependence must be determined. These activities should then be presented in a manner that will help grasp the complexities clearly and also help to determine slack, if any. It will also help in effective resource allocation considering the time period. In this section, we will discuss these issues:

Concept of network

Conceptually, we can say that a network diagram is a graphical presentation of all the activities of a project, arranged in a proper sequence and with clearly established interdependencies. The network diagram provides a full picture of the project. The diagram can be presented as:

(a) A Gantt chart
(b) A PERT (Programme Evaluation and Review Technique) diagram
(c) A CPM (Critical Path Method) diagram

PERT and CPM are quite similar, except in the incorporation of uncertainty of time needed for the completion of each activity.

Purpose of network analysis

The goals and purposes of network analysis can be listed as follows:

1. Identifying discrete activities and sub-activities.
2. Identifying events signalling either the beginning or ending of the activities.
3. Estimating the time taken for completion of each activity, if possible on crash basis, normal basis, worst-scenario basis.
4. Identifying interdependence, if any, of activities.
5. Identifying critical path, so that one may know the existence of slack time in any activity. This may be helpful in determining the degree of discretion to be given to a sub-project team and in determining the dynamic response cycle.

6. Identifying slack for efficient resource allocation.
7. Determining economics of crashing of activities.

Basic decisions

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Two basic decisions are important before the network techniques are deployed: one, whether to have multi-level scheduling and two, whether to have multi-project scheduling.

Multi-level scheduling

Different levels of management need different degrees of details in the schedule plan and network diagram. This is more desired in project planning, especially if the project work is an amalgamation of numerous tiny activities. Each minute activity cannot be incorporated in a single work plan, unless the project itself is small and simple (like replacement of machine). So, multi-level scheduling is more common and desirable.

When schedules are prepared at multiple levels, it is called multi-level scheduling. Three to four level schedules can be prepared depending upon the requirements: for example;

- ***Master project schedule*** is prepared for the top management. This is essentially the milestone chart which gives a one-glance picture of the total activities. Only major groups of activities are recognized as discrete activities and sub-activities are ignored: for example, activity groups can be land development, civil work, electric work, plumbing, mechanical work, etc. The details in each of these work packages are excluded from the master project schedule for convenience.
- ***Functional area schedules*** are prepared for the project related activities of each functional department. Usually, the functional heads would need this level of scheduling. The functional area schedule is essentially the sub-group of corporate level master schedule.
- ***Schedules of work packages*** are the detailed schedules for all work packages that form the part of either the master project schedule or the functional area schedule. This essentially serves the purpose for project sub-teams or subcontractors who execute the activities.

Multi-project scheduling

A firm, handling more than one project simultaneously, may require multi-project planning and resource allocation. Several resources, including manpower and money. are in common demand from all projects under construction. In that case, if separate project teams are allowed to operate independently, there could be conflicts and sub-optimal utilization of resources leaving unutilized resources some times and scarcity of resources some other times. The task of planning and control, therefore, is more difficult in multi-project activities.

In multi-project scheduling, all projects are collectively treated as a single project for the breakdown of work packages, their sequencing and resource allocation. Activities of one project may have a predecessor activities and/or successor activities in other projects. It becomes imperative for multi-project scheduling to follow multi-level scheduling also and plan for a greater degree of communication, reporting and coordination.

A firm may avoid difficulties of multi-project scheduling by scheduling each project independently but the costs and other potential conflicts in this approach may not be worth taking the risk.

CATS and RATS

One more decision is whether to have CATS only, RATS only or both. The term CATS stands for Critical Activity Time Schedule and the term RATS for Realistic Activity Time Schedule. CATS provides more stringent time standards for project execution, whereas RATS is based on achievable time schedule. Figure 8.3 gives an idea of how CATS and RATS compare.

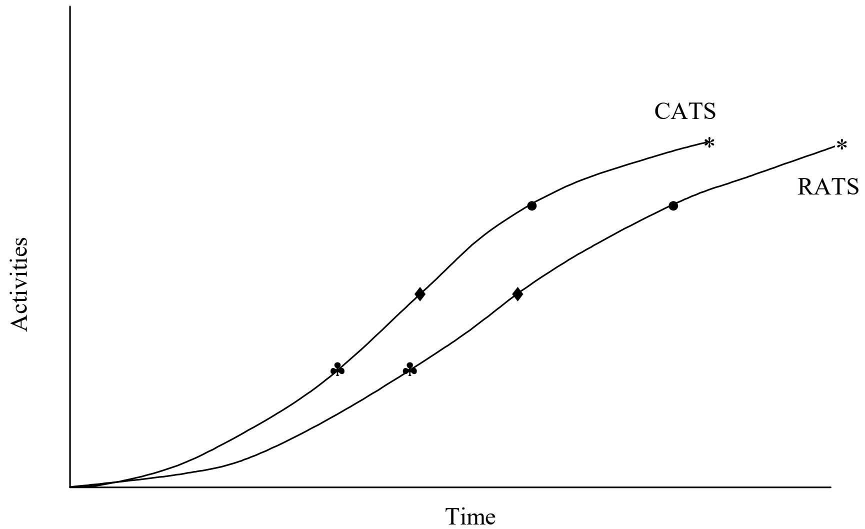

Fig. 8.3 *Critical Activity Time Schedule (CATS) and Realistic Activity Time Schedule (RATS)*

Both CATS and RATS are time schedules. CATS can be used to provide stringent time standards for project execution and can be useful for setting targets for project teams, machine fabricators and other project contractors for the completion time. Stricter standards may result in an effective execution of a project. RATS provide a more realistic time planning; therefore, it can be used for negotiations with funding agencies, who would expect timely attainment of major milestones in the project construction before they would release additional instalment of loan.

CATS and RATS have another purpose too. The difference between them could (a) reflect the risk associated with the time of completion and (b) cushion for contingency. Thus, evaluation of actual performance in the light of both CATS and RATS both would indicate whether the project is remaining within the boundary of acceptable level of risk associated with time.

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Steps involved in network techniques and analysis

Some steps must be followed for the preparation of a network diagram or critical path model and their application in project management decisions. Without distinguishing the network diagram and critical path, we can list the steps as follows:

1. Identify discrete activities and events
2. Establish interdependence of activities
3. Determine the time required for completion of each activity
4. Prepare a diagram with events, activities and time
5. Determine different paths for the completion of project construction
6. Identify a critical path that has the longest time for completion
7. Determine early start and finish time, as well as late start and finish time
8. Calculate total slack time and free slack time
9. Check if crashing of activity is feasible for early finish of the project

Application of network techniques

Now, let us apply the concept of network technique for which we will take a simple example that will be developed at each stage as needed.

Step 1: Activities and events

Activity is defined as the stage of work for the project. Activity could be either *real* or *dummy*. Real activities consume time and resources. Dummy activity is one that has no real successor. Dummy activities are used just to establish relationships; they do not consume time or resources but they are essential for building a network diagram. Note that in the example given in Table 8.3, activity d_1 is a dummy activity because no activity follows it. Dummy activity is depicted as dotted line for clear identification purpose.

Each activity has a beginning and an end. The beginning and the end are called '*Events*'. Events are defined points in a total project. Events occur instantaneously and have no duration. They do not consume time or resources. On a network diagram, activities are denoted by arrows and events are shown by circles. Dummy activities are shown in dotted line on the network diagram.

Step 2: Interdependence of activities

Activities are separated by events and they are sequenced in the order of a given technical or other type of dependence, if any. Dependency means, only after a predecessor activity is completed, the current activity can begin. If activity x can begin only after the activity n is completed, then activity n is a predecessor of activity x and activity x is the successor of activity n. In a master schedule network, it may be possible that a particular activity may begin when its predecessor activity is completed partially. Such interdependence is identified and recorded at this stage.

Prepare Network Diagram

At this stage, we can prepare a network diagram with events and activities.

Example 8.1: Network Diagram (Events and Activities)

Table 8.3 gives the list of activities and events with predecessors and successors for a project plan MM of a company.

Table 8.3 *Events and Activities in the Project Plan MM*

Activity			Event		
Identification	Predecessor	Successor	Identification	Predecessor	Successor
a	-	b, c	1, 2	1	2
b	a	d_1	2, 3	2	3
c	a	e	3, 4 dummy	3	4
d_1	b	e	2, 4	2	4
e	c, d_1	f, i	4, 5	4	5
f	e	g	5 6	5	6
g	f	h	6, 7	6	7
h	g	-	7, 8	7	8
i	e	-	5, 8	5	8

Prepare the network diagram for the project plan MM, with events and activities only.

Solution:

The data given in Table 8.3 of Example 8.1 can be presented as a network diagram given in Figure 8.4.

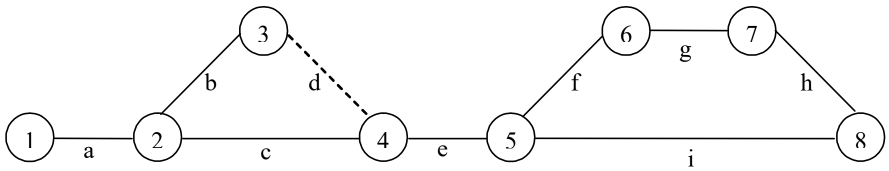

Fig. 8.4 *Network Diagram with Events and Activities*

Step 3: Estimate time for each activity

It is important to estimate the time required for completion of each activity. Time may be a point forecast or more appropriately multiple estimates of possible times for a given activity. Given a level of uncertainty associated with the completion time, one may estimate (a) optimistic time, which is the shortest, (b) pessimistic time, which is the longest, (c) most likely time, which is somewhere between the optimistic and the pessimistic estimates of time and (d) estimated time, which is estimated based on all the previous three estimates of time. Estimated time may either be an average of the optimistic, pessimistic and the most likely time. Often, a different weight is assigned to one or more of the time estimated in determining the estimated time.

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Remember that dummy activities do not consume time.

Example 8.2: Estimating Time

Continuing Example 8.1on the project plan MM, we have been given in Table 8.4, the forecast of time for the completion of each activity:

Table 8.4 *Time Estimate for Various Activities involved in Project Plan MM*

Activity	t_o	t_m	t_p
a	2.4	3.7	5.6
b	4.0	5.0	9.0
c	1.6	2.8	5.2
e	3.0	3.7	6.2
f	4.8	6.4	9.8
g	2.2	3.2	6.0
h	3.5	4.4	8.9
i	3.3	4.6	9.5

All times listed are in **work weeks** (Mon– Fri, 8 A.M. to 5 P.M. with a one hour daily lunch break)

Here, t_o = Optimistic time or crash time

t_m = Most likely time

t_p = Pessimistic time or maximum time

Required: (a) Calculate the estimated time (normal time) assigning 4-times weight to the most likely time.

Solution:

Time estimated using the weights given in the example and given in Table 8.5.

Table 8.5 *Calculating Estimated Time*

Activity	t_o (a)	t_m (b)	t_p (c)	Calculation of t_e [a + 4c + d) ÷ 6	t_e
a	2.4	3.7	5.6	[2.4 + (4×3.7) + 5.6] ÷ 6 =	3.8
b	4.0	5.0	9.0	[4.0 + (4×5.0) + 9.0] ÷ 6 =	5.5
c	1.6	2.8	5.2	[1.6 + (4×2.8) + 5.2] ÷ 6 =	3.0
e	3.0	3.7	6.2	[3.0 + (4×3.7) + 6.2] ÷ 6 =	4.0
f	4.8	6.4	9.8	[4.8 + (4×6.4) + 9.8] ÷ 6 =	6.7
g	2.2	3.2	6.0	[2.2 + (4×3.2) + 6.0] ÷ 6 =	3.5
h	3.5	4.4	8.9	[3.5 + (4×4.4) + 8.9] ÷ 6 =	5.0
i	3.3	4.6	9.5	[3.3 + (4×4.6) + 9.5] ÷ 6 =	5.2

Note: t_e = estimated time or normal time

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Note that the weight and the method of calculation of t_e (estimated time) may vary as per the choice of the person or organization that estimates it. In this case, t_m (most likely time) is given four times the weight of t_0 (optimistic time) and t_p (pessimistic time).

Step 4: Network diagram

A useful network diagram can be prepared now using the identified activities and their relationship along with the activities and time estimates for the completion of each activity. We will discuss the usefulness of network diagrams after we get a view of the network diagram based on Examples 8.1 and 8.2.

Example 8.3: Network Diagram (Events, Activities and Time)

Using data given in Example 8.1 and Example 8.2 and their solution (a) prepare Gantt chart and (b) prepare a CPM diagram with the events, activities and time for the project plan MM.

Solution:

(a) First, we will prepare a Gantt chart and then CAPM.

In the Gantt as well as the critical path method diagram, we use only the estimated time or the normal time. The Gantt chart can be prepared using any standard project management software. Free online software for the preparation of Gantt chart is available at the following link:

http://www.viewpath.com/SignupIQ/Promotions/G_Gantt/

Gantt chart

The **Gantt chart** for our example will look like the one given in Figure 8.5.

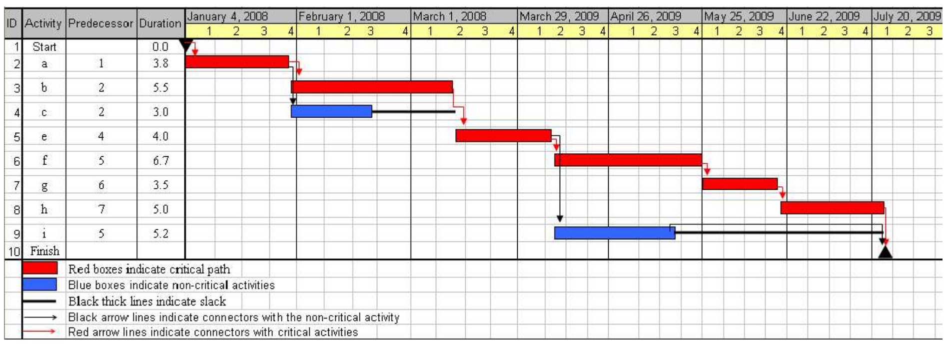

Fig. 8.5 *Gantt Chart*

Note: (1) the critical path is in red. (2) The slack activity is in the black lines connected to non-critical activities. (3) Solid black line indicate slack. (4) Red arrow line indicates connectors with critical activities. (5) Black arrow line indicates connectors with non-critical activity.

Now, we will draw a network diagram with events, activities and time. It is given in Figure 8.6.

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Network diagram and PERT

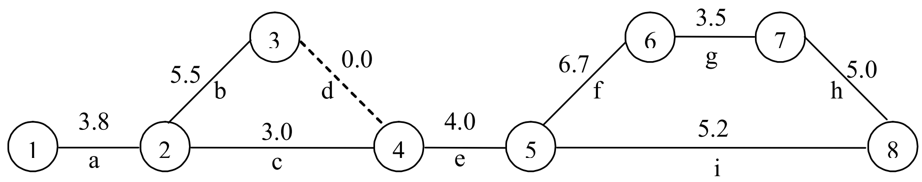

Fig. 8.6 *Network with Events, Activities and Time*

Step 5: Identify different paths and time

After the network is prepared with events, activities and time, one must identify different paths through the project.

Example 8.4: Identifying Different Paths and Time

Using Examples 8.1 to 8.3 presented previously and their solution, identify different paths for the completion of project plan MM.

Solution:

Look at Figure 8.5 of network with events, activities and time and visualize the various alternative paths through the project. There are four alternative paths available leading to the final event number eight. These four alternative paths are given in Table 8.6 along with the calculation of time taken to follow the respective path.

Table 8.6 *Different Paths through the Network of Project Plan MM*

No.	Events on the Path	Time to Complete all Events
1	1-2-4-5-8	16.0 = 3.8+3.0+4.0+5.2
2	1-2-3-4-5-8	18.5 = 3.8+5.5+0.0+4.0+5.2
3	1-2-4-5-6-7-8	26.0 = 3.8+3.0+4.0+6.7+3.5+5.0
4	1-2-3-4-5-6-7-8	28.5 = 3.8+5.5+0.0+4.0+6.7+3.5+5.0

Step 6: Critical path and slack paths

One of the different paths available is a critical path. A path that takes the longest time is called a *critical path* and other paths are called *slack paths*. Critical path represents the minimum time required for the completion of a project. If project network is changed, the critical path also may change. Observe that the activities on the slack paths are pursued simultaneously with the activities on the critical path.

Example 8.5: Identifying Critical Path

Find the critical path from the different paths identified in solution to the Example 8.4 in Table 8.6.

Solution:

The longest time path is called the critical path. Reading Table 8.8, it appears that for the project plan, MM path number 4 (which is 1-2-3-4-5-6-7-8) is the longest consuming 28.5 weeks for completion. All other paths are slack paths. The critical path is shown with solid red hard lines on the network diagram given in Figure 8.7.

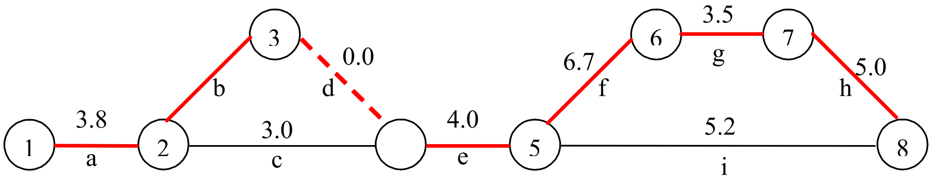

***Fig. 8.7** Critical Path on the Network with Events, Activities and Time*

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Step 7: Early start and finish time and late start and finish time

Project planning is done but it can still be planned better if we determine early start and early finish time as well as late start and late finish time. We compute these in order to gain a better understanding of the relationships among various project activities and attempt to reduce the project duration, if possible.

Early start (ES) time is the earliest time when an activity can be initiated. This depends on the completion of the predecessor activities. Adding the time required for completing the activity, we get early finish (EF) time for the activity.

Late start (LS) of an activity is the latest time an activity can be started without delaying the completion of the project. These are calculated using backward calculation from the end of the project.

Latest finish (LF) is a sum of the latest start time of an activity and the time (t) taken to complete it.

Example 8.6: Early Start (ES) and Early Finish (EF) as well as Late Start (LS) and Late Finish (LF)

Calculate the early start (ES) and early finish (EF) for activities e (4-5) and i (5-8). Also, tabulate all the values of ES, EF and LS and LF.

Solution:

Early start (ES) for activity e (4-5) = EF a (1-2) + EF c (2-4) = 3.8+3.0 = 6.8 weeks

Early finish (EF) for activity e (4-5) = ES for e + t (e) = 6.8 + 4.0 = 10.8 weeks

Early start (ES) for activity i (5-8) = EF a (1-2) + EF c (2-4) + EF e (4-5) = 3.8+3.0+4.0 = 10.8 weeks

Early finish (EF) for activity i (5-8) = ES for i + t (i) = 10.8 + 5.2 = 16.0 weeks

Late start (LS) for activity i (5-8) = 28.5 – 5.2 = 23.3 weeks

Late finish (LF) for activity i (5-8) = 23.3 + 5.2 = 28.5 weeks

Late start (LS) for activity e (4-5) = 28.5 – 5.0 – 3.5 – 6.7 – 4.0 = 9.3 weeks

Late finish (LF) for activity e (4-5) = 9.3 + 4.0 = 13.3 weeks

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The early start (ES) and the early finish (EF) as well as the late start (LS) and the late finish (LF) are tabulated in Table 8.7.

Table 8.7 *Early and Late Time Estimates*

Activity	Earliest		Latest		Slack	
	Start	Finish	Start	Finish	Start	Finish
a	0.0	3.8	0.0	3.8	0.0	0.0
b	3.8	9.3	3.8	9.3	0.0	0.0
c	3.8	6.8	6.3	9.3	2.5	2.5
e	9.3	13.3	9.3	13.3	0.0	0.0
f	13.3	20.0	13.3	20.0	0.0	0.0
g	20.0	23.5	20.0	23.5	0.0	0.0
h	23.5	28.5	23.5	28.5	0.0	0.0
i	10.8	16.0	23.3	28.5	12.5	12.5

Step 8: Total and free slack time

The difference between the latest and the earliest start times of an activity is called *total slack time*. It is also calculated as a difference between the late and the early finish times.

Free slack time is the difference between the early finish time of an activity and the most early start time from among all its immediate successor activities.

Activities on the critical path have no slack time. Knowing free and total slack time of non-critical activities helps in scheduling the activities and one may concentrate on the critical path and take advantage of the knowledge about the slack available on non-critical path activities.

This discussion also implies that the total slack time and the free slack time for a non-critical activity will be different only if the non-critical activity has more than one successor. If there is only one successor to a non-critical activity, the total and the free slack will be the same and that will be equal to the slack we tabulated in Table 8.7.

The project procurement officer would carry out a detailed slack time analysis and help in making a final schedule for efficient procurement of resources.

Example 8.7: Total and Free Slack Time

Using the data in Examples 8.1 to 8.6, calculate the total and free slack time for all non-critical activities. Remember, activities c and i are non-critical activities.

Solution:

In our example, there is only one immediate successor for each of the non-critical activities c and i. Therefore, total slack and free slack will be the same for both.

From Table 8.7 we conclude that,

Non-critical activity c has 2.5 weeks total slack time and free slack time.
Non-critical activity i has 12.5 weeks total slack time and free slack time.

NOTES

Step 9: Crashing of activities for early completion of project

Activities on the critical path may be undertaken on urgency basis to complete them in less than the 'estimated time'. Crashing of critical activity may become necessary in two situations; one, when a project is running late and on-time completion is important and two, with the additional set of information, early completion of a project is considered more advantageous than the cost associated with the crashing of activities.

The difference between optimistic time and estimated time indicates the possibility of crashing of the activity. Crashing of activity may have net extra cost (because it may save some fixed costs and interest against the additional expenses of huge resource mobilization) but it helps in timely or early completion of a project. The additional cost may be justified if additional revenue during the time saved on the project completion is more than the cost of crashing.

Example 8.8: Crashing of activities

Consider the crash time and crash cost per week for each activity on the critical path as given in Table 8.8 for the project plan MM example we discussed in Examples 8.1 through 8.7.

Table 8.8 *Crash Time and Cost for Critical Activities*

Activity	Normal Time	Crash Time	Crash Cost per Week
a	3.8	1.0	₹ 5,000
b	5.5	0.5	2,500
c	4.0	1.1	4,600
f	6.7	1.5	4,100
g	3.5	0.7	3,200
h	5.0	0.8	2,500

If the management wants to reduce the total project construction time from 28.5 weeks to 26.0 weeks, suggest the activities that can be crashed, recommend to what extent each one of your recommended activities must be crashed and calculate the activity-wise and total crashing costs.

Solution:

First, there is no advantage in crashing non-critical activities. From among the critical activities given in Table 8.9, the selection of activities for crashing would be on the basis of the least cost per week.

NOTES

Table 8.9 Crashing of Activities

Activity	Normal Time	Crash Time	Crash Cost per Week (₹)	Crash Rank	Activities and Weeks Proposed for Saving	Total Crash Cost (₹)
a	3.8	2.8	5000	6		
b	5.5	5.0	2500	1	0.5	Rs 1250
c	4.0	2.9	4600	5		
f	6.7	5.2	4100	4		
g	3.5	2.8	3200	3	1.2	3,840
h	5.0	4.2	2700	2	0.8	2160
				Total	2.5	7250

The target of reducing project construction time from 28.5 weeks to 26 weeks should be achieved by crashing activity b by 0.5 week, activity h by 0.8 week and activity g by 1.2 weeks. This crash schedule will cost more by ₹ 7250 in exchange of savings of 2.5 weeks in project construction.

Network technique is the single most important technique in the project management that lays out a systematic plan for execution and control of the project. The goals of network techniques are manifold, which could be achieved if one goes through the steps systematically and explores the options for resource planning and crashing based on network analysis.

8.4.3 Financial Analysis and Evaluation

Good market demand and suitability of technical specifications of technology and processes may not be worth it if one cannot make money. Financial analysis involves detailed calculations to verify financial outcomes of the project. Financial analysis accepts marketing and technical assumptions developed during market analysis and technical analysis and goes further into estimating investment requirements, financing plan, working capital plans and cost estimates for the operations. These financial estimates are then used for calculating project cash flow and cost of capital before the financial viability is determined using one or more evaluation techniques. A financial analysis will check whether various financial milestones could be achieved from the project. These milestones are defined in terms of payback period, accounting rate of return, net present value or internal rate of return and in terms of average interest cover ratio and average debt service coverage ratio, etc.

Before any financial analysis is carried out, some basic decisions must be in place. These include the period of analysis, a tentative choice of financing mix, cut-off decision and choice of evaluation techniques. These four basic decisions as a prerequisite of financial analysis are briefly explained here and will be referenced in the discussion in the later part of the material in this unit.

1. Period of analysis

What should be the period of analysis? One year, five years, how much longer? This question may sound naive, but it is quite important. One might opine that the life of a project should be the length of time for which the financial analysis must be done. How can we, however, determine the life of a project? If we can, then what about the future projects dependent on the current project? If we know the project life and if it is really long (as is usually the case), are we in a position to make a forecast for that long a period? What about the risk if we attempt to forecast for a very long period?

Usually, the period of forecast is a matter of the company's policy based on the considerations of factors like product life cycle, business cycle, rate of change in technology, rate of change in taste, managerial ability to foresee in the future and database available to support the forecast. Information technology projects typically can be planned for about three years due to the technological development rate, short product life cycle and uncertainty caused by low entry barrier.

There are other reasons for limiting the length of period for financial analysis. Some of them are as follows:

1. Project report for the purpose of loans will be prepared for the period of the loan because the lending agency would like to know the project cash flow for the safety of their money, which is loaned for a particular period only.
2. Time value (discounted cash flow) based evaluation techniques are sensitive to the cut-off rate and the length of time and their results become less relevant for decision-making with the increasing span of time in analysis, especially when the cut-off rate is high. One can give a thumb rule that for a cut-off rate of around 15 per cent, about a 10-year analysis will be fine if time value based techniques are used.

What if length of analysis is restricted?

If for some reasons, the length of analysis is restricted to less than the approximate project life, then it is appropriate to forecast the resale value of all assets at the end of the terminal period, (i.e., the end of the analysis period) and incorporate the terminal value in the last year's cash flow for the project. The estimated value of working capital released in the terminal period is also recognized at this point.

2. Financing mix and cost

At this stage, the firm might not have raised capital for financing the project. However, the company must still make a tentative decision about the financing mix for the project and about the design of instruments for raising funds. How much equity funds and loan funds will be obtained? How are equity funds raised (internally through retained earnings or through issue of new shares)? What will be the features of debt security? These questions must be answered at least on a tentative basis. The financing mix decision has three purposes:

1. Investigating the effect of new project financing on the company's capital structure. Sometimes, a capital-intensive project may not become feasible

NOTES

if it may result in a skewed capital structure with a very high debt as the only possible way of financing the project. In that case, the firm may have to abandon the very idea of the new project or explore other options.

2. Approximating the cost of each type of new funds that will be raised for financing the new project.
3. Approximating the weighted average cost of capital which can be used in deriving the cut-off rate required for accepting the new project.

3. Cut-off criterion

Cut-off decision is a benchmark against which the project cash flow stream is compared to determine whether the project would attain its financial goal. A cut-off rate is sometimes called a go-no-go criterion, hurdle rate, or required rate of return.

A cut-off criterion would depend on the techniques applied for the evaluation of project cash flow stream. If time value-based evaluation techniques are used, the cut-off rate will be determined on the basis of cost of capital. This involves the calculation of cost of capital. For other techniques where time value concept is not used, the appropriate cut-off must be decided.

There is a general belief that one has to use the cost of capital as the cut-off point when time value-based techniques are used. In the following situations, this may not hold true and a cut-off rate must be determined separately:

1. If the new project is likely to change the risk profile of the company, the cut-off rate will be different from the cost of capital. In this case, the cost of capital prior to and after the announcement of the project will be different.
2. In most cases, a firm undertakes more than one project and makes a financing plan for a group of projects. The risk associated with each project in the group will be different, warranting different cut-off rates for different types of projects. For example, in a given capital budget period, a company might have some replacement projects, one or more expansion projects, one new product development project and a research and development project; each one with a different risk profile. Not all these projects can be decided using the same cut-off rate.

The contribution of the proposed project in the total risk of business must be factored in the cut-off rate in addition to the cost of capital. The resultant cut-off rate may be either more or less than the weighted average cost of capital depending on whether the project enhanced the risk of the business or reduced it. There are several methods for factoring changing risk profile in the cut-off rate decisions, some of which are built around cost of capital and some others without cost of capital.

NOTES

An ideal cut-off rate can be calculated in many alternative ways such as the following:

1. By adding risk premium in the risk-free rate of return. The risk-free rate is usually drawn from treasury bonds. The amount of risk premium is decided on the basis of change in the risk profile of the business as a result of accepting the new project.
2. By using the capital asset pricing model (CAPM), it can be applied to real assets as opposed to financial assets. The CAPM is only rhetorically appropriate in determining the rate of expected returns from a project.
3. A more pragmatic solution to the cut-off rate decision lies in taking a risk-adjusted rate of return. Risk-adjusted rate of return is calculated by adding/ subtracting the differential risk from the weighted average cost of capital.

4. Choice of evaluation technique

There are many techniques for the evaluation of investment proposals. Some focus on capital recovery, some measure profitability and some take into account the time value of money. A company must select one or more appropriate evaluation techniques. Usually, firms select a set of evaluation techniques to attain multiple goals. For example, a firm may use the pay-back period (capital recovery period) method as well as the net present value method for ensuring good liquidity as well as value creation from the project.

Companies also develop a policy for the application of techniques. These policies vary depending upon the type of project. A project of establishing a new market territory may be evaluated on the basis of accounting rate of return but replacement of machines on the basis of net present value.

An appropriate evaluation technique is one that may be justifiably applied to a given investment proposal for the attainment of financial and non-financial goals within the constraints in which the firm operates.

Cost of capital and cut-off decision

We need to determine cut-off rate for the financial evaluation of a project. One important method of determining the cut-off rate is based on the weighted average cost of capital, which in turn needs cost of debt and cost of equity. In this section, you will learn to calculate cost of debt, cost of equity and weighted average cost of capital before proceeding to look at the methods for determining the cut-off rate.

You must be familiar with the concept and calculation of time value of money with a view to grasp this topic and the topic of evaluation techniques covered in the next unit. Especially, ability to calculate the present value of given cash flow stream and ability to calculate the internal rate of return will be important and helpful.

NOTES

1. Cost of debt

Debt already obtained by a firm has a defined and contracted cash flow commitment against the exact amount that the firm received. Therefore, the cost of debt can be easily calculated by considering the following steps:

a. Know the policies related to the treatment of upfront costs associated with debt
b. Know the marginal tax rate
c. Prepare the cash flow stream associated with the debt on after-tax basis
d. Find the rate at which the present value of cash outflows equals the initial inflow
e. Find the annual rate, if coupon is paid more frequently than once a year

These steps are explained as follows:

(*a*) Know the policies related to the treatment of upfront costs

Raising funds cost money in the beginning. This is called floatation cost. Depending on the size of the issue and the issuer's market image, the issue of bonds may cost seven to eight per cent. Bank loan also has some upfront costs. Firms adopt one of the following two alternative policies for the treatment of this upfront cost:

- Include the floatation cost as the cash outflow in the project cash flow.
- Include the floatation cost as the cash outflow in the calculation of the cash flow associated with the debt, i.e., include in step c of the calculation of cost of debt.

Conceptually, floatation cost is the financing cost and therefore, must not be included in the project cash flow but must be treated as the debt cash flow and is considered as the correct policy. However, for many practical reasons, some firms treat floatation cost as the project cash flow. Whatever the policy used, one must make sure that the upfront cost is not included at both places.

(*b*) Know the marginal tax rate

There may be situations where the income tax rate may be progressive. A progressive rate means a lower rate for lower income and higher rate for additional income. In India, personal income tax rate follows the progressive rate concept but corporate tax rate is flat. Domestic companies are charged a flat rate of 35 per cent plus a 2.5 per cent surcharge.[7] Foreign companies are taxed at a higher rate. Therefore, 37.5 per cent flat rate is also a marginal rate for domestic companies and that is applicable to the debt cash flow.

If progressive rate is followed, then one has to estimate taxable income in different years and marginal income tax rate applicable for that marginal income in the respective year must be selected for tax adjustment in the calculation of cost of debt.

NOTES

(*c*) Prepare the debt cash flow stream

Using the terms and conditions of debt (issue price, coupon rate, frequency of payment of interest, maturity period and maturity amount) along with the information about the par value, issue price and policy for the treatment of upfront cost, we can prepare the cash flow stream during the life of the debt. Prepare the debt cash flow for the application of the next step.

Do not forget to factor the tax at this stage and obtain the debt cash flow after tax. Some do not factor the tax in debt cash flow in this step but first find the rate as in step d and then adjust for the tax as an additional step. In fact, adjustment of tax in this step is more appropriate.

(*d*) Find the rate

This is just a mathematical process to find the rate at which the present value (discounted value) of the cash outflow stream is equal to the initial cash inflow. This rate is the cost of debt. The equation can be written as follows:

$$CF_0 = \frac{CF_1}{(1+R)^1} + \frac{CF_2}{(1+R)^2} + \frac{CF_3}{(1+R)^3} + \dots\dots\dots + \frac{CF_n}{(1+R)^n} \qquad (8.1)$$

Here, CF_o = Initial cash inflow

CF_1 through CF_n = Cash outflow on debt servicing from year 1 to year n, n being the last year.

R = Cost of debt. It is the rate at which the present value of all cash outflows is equal to the initial cash inflow received at the time of raising the debt

Or,

$$CF_0 = PV_{R,t} = \sum_{t=1}^{n} \frac{CF_t}{(1+R)^t} \qquad (8.2)$$

Here, $PV_{R,t}$ = Present value at the rate R for the cash flow of period t

CF_t = Cash flow in year t

Solve for R to get the cost of debt. Solving for R means finding the internal rate of return (IRR) for a given cash flow stream. Please read the IRR calculation method in the following unit.

If tax is not factored at the time of preparing the debt cash flow stream, you get K_d that is in pre-tax terms. One needs to adjust it with tax to get post-tax K_d. The formula for such adjustment is,

$$K_d = R \times (1-t) \qquad (8.3)$$

NOTES

Here, t = Tax rate

Let us repeat; it is appropriate to take after-tax debt cash flow in step c, rather than adjusting tax-using Equation 8.1.

(*e*) Find annual rate if coupon is paid more than once a year

It is a common practice to pay interest (coupon) rate on bonds and other debt instruments more frequently than once a year. In that case, debt cash flow in step c will be the periodic cash flow (if coupon is paid semi-annually, cash flow will be semi-annual and if coupon is paid quarterly, then cash flow will be quarterly). Therefore, the rate we get in step d will be the periodic rate (semi-annual or quarterly or monthly). In this case, this step is essential for converting the periodic rate into the annual rate (called annual percentage yield or *APY*). *APY* is calculated from the periodic rate using the following formula:

$$APY = K_d = (1+R)^i - 1 \qquad (8.4)$$

Here, APY = Annual percentage yield (which is K_d here)

R = Rate found in step c, which is a periodic rate for frequent interest payment than once a year

i = Number of times interest is paid in a year

Examples of cost of debt

Consider the following examples and calculate the cost of debt.

Example 8.9: Cost of debt without floatation cost, interest paid annually

Company A has borrowed a sum of ₹ 1,000 at an interest rate of 15 per cent per year. Interest is payable every year and the principal sum at the end of five years from now. The applicable tax rate is 37.5 per cent. What is the cost of borrowings?

Solution:

Step a is not necessary because there is no upfront cost.

Step b: Information is given; tax rate is 37.5 per cent.

Step c: Calculating debt cash flow stream after tax:

In year 0 (i.e., now or at the time of taking loan): the firm receives ₹ 1,000.

In year 1 through year 5: Interest payment ₹ 150 (15 per cent × ₹ 1,000) before tax.

Tax saved on interest payment: ₹ 56.25 (₹ 150 × 37.5 per cent).

Net to tax cash outflow: ₹ 93.75 (₹ 150 – ₹ 56.75).

In year 5: Payment of principal sum ₹ 1,000.

Thus, total debt cash flow stream over the timeline will be as per Table 8.10.

NOTES

Table 8.10 Total Debt Cash Flow Stream over Timeline

Year	Cash Flow
0	1000.00
1	-93.75
2	-93.75
3	-93.75
4	-93.75
5	-1093.75

Step d: To find the rate let us put cash flow in Equation 8.1,

$$CF_0 = \frac{CF_1}{(1+i)^1} + \frac{CF_2}{(1+i)^2} + \frac{CF_3}{(1+i)^3} + ...+ \frac{CF_n}{(1+i)^n}$$

$$₹\ 1{,}000 = \frac{-93.75}{(1+R)^1} + \frac{-93.75}{(1+R)^2} + \frac{-93.75}{(1+R)^3} + \frac{-93.75}{(1+R)^4} + \frac{-93.75-1{,}000}{(1+R)^5}$$

Solving for R,

$$R = K_d = 9.375 \text{ per cent}$$

Note that the 9.375 per cent rate is the same as the rate of one interest payment after tax. Every year, Company A pays after tax of ₹ 93.75 on ₹ 1,000 borrowing, which is 9.375 per cent rate. The cost of debt will be the same as the after-tax coupon rate if two conditions are fulfilled, namely (i) the amount of loan and the amount repaid on maturity are equal and (ii) interest is paid at the same rate and at the equal interval of time. In Example 8.9 these conditions are fulfilled. In that case, we can calculate the cost of debt by taking after-tax interest rate. In most cases, condition (i) is rarely met because of upfront costs associated with the issue of bonds or with loan. In some cases, some premium is paid at the time of repayment and condition (i) is violated. In some cases, there may be a provision for no or low interest rate in the beginning few years, which would violate condition (ii). When any of these two conditions are not met, it is better to use Equation 8.1. Let us take another example with floatation costs.

Cost of Debt that is not Yet Issued

Projects are often financed with new issue of debt. In that case, the company has to determine the cost of debt that will be obtained in the near future. One needs to estimate the cost of debt that will be issued before the future cost of capital is calculated. There may be two situations here, (a) the firm has outstanding bonds already traded in the market and (b) the firm has no outstanding bonds as of now. Let us discuss how to calculate the cost of debt in both the situations.

(a) If a Firm has outstanding bonds

The cost of new bonds can be derived from the yield that investors get on outstanding bonds. Two types of yield calculations are useful for this purpose (i) current yield and (ii) yield to maturity. The formulas for both are given as follows:

NOTES

Current yield

$$Current\ Yield = \frac{Annual\ Interest\ Amount\ After\ Tax}{P_0} \quad (8.5)$$

If par value of bonds is ₹ 100, then this formula can be re-written as,

$$Current\ Yield = \frac{Interest\ Rate\ After\ Tax}{P_0} \quad (8.6)$$

Here, P_0 = Price of bonds at zero period (now)

Yield to maturity (YTM)

This is the yield (return) of an investor who buys the outstanding bonds now at the current price and holds them up to maturity. *YTM* is calculated using Equation 8.1 with a difference that P_0 is taken as CF_0, because that is the cash flow for investors at zero period.

Example 8.10: Cost of debt that is not yet issued

Take Example 8.9 where Company A has borrowed a sum of ₹ 1,000 at the interest rate of 15 per cent per year. Interest is payable every year and principal sum at the end of five years. The tax rate applicable is 37.5 per cent. Assume that these ₹ 1,000 par value bonds were issued one year earlier and their current price in the market is ₹ 975. Calculate coupon rate and cost of debt on the new issue of bonds using (i) the current yield and (ii) the yield to maturity for these bonds.

Solution:

Current yield: Using Equation 8.5

For calculating the coupon rate on new bonds, we will take the current yield on pre-tax cash flow:

$$Current Yield = \frac{150}{975} = 15.385\%$$

For calculating the cost of new debt on new bonds we must take after-tax cash flow:

$$Current Yield = \frac{93.75}{975} = 9.615\%$$

(ii) Yield to maturity (YTM):

An investor who pays ₹ 975 for the outstanding bond will get ₹ 150 on pre-tax basis every year and ₹ 1000 back at the end of the 4th year. Plugging these numbers in Equation 8.1, we can get *YTM* on pre-tax basis and that is what should be the coupon rate of the new bonds if issued now:

$$YTM\ based\ Coupon\ Rate = ₹\ -975 = \frac{150}{(1+R)^1} + \frac{150}{(1+R)^2} + \frac{150}{(1+R)^3} + \frac{150+1{,}000}{(1+R)^4} = 15.89\%$$

For calculating *YTM* based cost of the new bonds we will take after tax cash flow,

NOTES

$$YTM\ (based\ Cost\ of\ Debt) = ₹ -975 = \frac{93.75}{(1+R)^1} + \frac{93.75}{(1+R)^2} + \frac{93.75}{(1+R)^3} + \frac{93.75+1{,}000}{(1+R)^4}$$

Solving for –*R* we get *YTM* = 10.167 per cent

YTM is more than the current yield in this case because the bonds are traded below par. If the bond price is equal to par, then *YTM* and the current yield will be equal and if the price is more than the par, *YTM* will be less than the current yield.

K_d using yield: Discussion

Why do we take the 'yield on outstanding bonds' approach for the calculation of the cost of debt that will be obtained now? Shall we use current yield or yield to maturity as the cost of debt that will be obtained now? Read the following answers:

1. Investors' yield on outstanding bonds represents market expected returns from the bonds of the company, given the risk and other factors. If the new bonds are issued, then investors will expect the same return on the new bonds if they are issued now. Therefore, yield on the outstanding bonds becomes a good indicator of the cost of new bonds.
2. It is better to use *YTM* as the cost of new bonds, if the new bonds have a maturity period equal to the time-to-maturity of the outstanding bonds. In Example 8.11, if the firm issues new bonds for four years, then *YTM* of 10.167 per cent is the more accurate cost of new bonds that will be issued now. *YTM* accurately reflects all the components of interest rate for the time-to-maturity only. These components may be different in the years after that.
3. However, if the maturity of the bonds is either not decided or unlikely to be equal to the time-to-maturity of the outstanding bonds, we can safely assume that an investor is buying the outstanding bonds with the intention of holding them for a short time before he sells the bonds. With that assumption, current yield on the outstanding bonds becomes an acceptable cost of debt for those bonds that will be issued now.

(b) If a firm does not have outstanding bonds

It is not easy to determine the cost of debt that is not raised yet, especially if the firm currently has no outstanding bonds. If the public issue of bonds is planned, then one can come to some judgement about the cost of bonds only during the book-building exercise after the road-show is conducted but that is quite late in the actual financing exercise for the project; little too late for knowing the cost for financial analysis purpose. Therefore, an initial negotiation with any lending institution will only give a fair idea about the cost of new debt. Or, one can simply approximate the borrowing rate based on current profitability and risk in this situation but that will be just an internal assessment, rather than a market response.

NOTES

2. Cost of Equity (K_e)

It is most difficult to calculate the cost of equity, because the cash flow obligation associated with the equity is unknown as servicing of equity is not a contractual liability. Payment of dividends to equity shareholders is determined by the distributable profit earned by the firm as well as the amount retained for financing the growth requirement. Still, we need to estimate equity shares related cash flow or its surrogates for the calculation of the cost of equity.

The following are various methods of calculating cost of equity are listed below and some important ones also are explained:

- Dividend yield approach (constant dividend model and constant dividend growth model)
- Earning-price ratio
- Realized yield approach
- Bond-yield plus risk premium
- CAPM approach

The first three methods are expected to give the same answer under the set of assumptions. Bond-yield plus risk premium method is based on judgement; whereas, capital asset pricing model (CAPM) gives empirical evidence of a particular rate of K_e.

Dividend yield approach

This is a cash flow approach, where cost of equity is equal to the rate at which the present value of dividend cash flow estimated over infinite time, is equal to the current price of shares. The basic equation is similar to Equation 8.11 (except that CF_0 is denoted by P_o, CF_1 to CF_n are denoted here as D_1 to D_n, and R is denoted as K_e). With these changes, Equation 8.1 would look like,

$$P_0 = \frac{D_1}{(1+K_e)^1} + \frac{D_2}{(1+K_e)^2} + \frac{D_3}{(1+K_e)^3} + \ldots\ldots\ldots + \frac{D_n}{(1+K_e)^n} \qquad (8.7)$$

- *Constant Dividend Model (in Case of 100 Per cent Payout)*

  If the firm is paying out the entire amount of profit every year, the dividend is likely to remain constant. In that case, $D_1, D_2, D_3 \ldots D_n$ will be equal in Equation 8.7. If so, Equation 8.7 will reduce to the following due to infinite geometric progression (and that is quite similar to Equations 8.5 and 8.6.

$$K_e = \frac{D}{P_0} \qquad (8.8)$$

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Example 8.11: MNO Co. Ltd's shares are quoted at ₹ 120 per share. The company is likely to pay a dividend of ₹ 20 per share next year, which is a 100 per cent payout of profit, which implies that the rate of dividends will remain constant. Calculate K_e of this company's shares.

Solution:

Investors will get ₹ 20 every year up to an infinite period. Using Equation 8.8

$$K_e = \frac{D}{P_0} = \frac{20}{120} = 16.67 \text{ per cent}$$

- Constant Dividend Growth Model (in Case of Partial Payout)

  Most firms pay less than what they earn. Retained funds are deployed in the business, which in turn would increase the firm's profit and dividends. This means the dividend cash flow will grow. With the assumption that the return on equity will remain constant and the dividend will grow at the constant rate, Equation 8.18 can be rewritten as,

$$P_0 = \frac{D(1+g)^1}{(1+K_e)^1} + \frac{D(1+g)^2}{(1+K_e)^2} + \frac{D(1+g)^3}{(1+K_e)^3} + ...+ \frac{D(1+g)^n}{(1+K_e)^n} \qquad (8.9)$$

Or,

$$P_0 = \frac{D(1+g)}{K_e - g} = \frac{D_1}{K_e - g} \qquad (8.10)$$

Or, with cross-multiplication, we get equation for K_e,

$$K_e = \frac{D(1+g)}{P_0} + g = \frac{D_1}{P_0} + g \qquad (8.11)$$

Here, P_0 = Current share price

g = Growth rate in dividends

Note that Equations 8.9 and 8.10 are essentially the same and Equation 8.11 is derived from them by cross-multiplication.

Example 8.12: Current market price of shares of ABC Ltd is ₹ 160. Last year's dividend was ₹ 15 per share. It is expected that given the profitability rate of ABC Ltd, dividend will grow at the rate of 7 per cent per year. What is the K_e of this company?

Solution:

Using Equation 8.11,

$$K_e = \frac{15(1+0.07)}{160} + 0.07 = \frac{16.05}{160} + 0.07 = 0.1003 + 0.07 = 17.03\%$$

Earning-price (EP) ratio

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This is very similar to the dividend yield approach of calculating cost of equity, because in case of 100 per cent payout policy, E (EPS = earnings per share) and D (dividend per share) are equal.

$$K_e = \frac{E}{P} \tag{8.12}$$

Here, E = Earnings per share

P = Price per share

Realized yield approach

Yield that a shareholder, who bought shares one year ago and sold now after receiving dividend, gets is called realized yield. That is, the cost of equity. This can be expressed as,

$$P_{-1} = \frac{P_0 + D}{1 + K_e} \tag{8.13}$$

This can be rewritten as,

$$K_e = \frac{P_0 + D}{P_{-1}} - 1 \tag{8.14}$$

Here, P_{-1} = Price of share last year

P_0 = Price of share now

D = Dividend received during the period

For example, price of a company's share one year back was ₹ 180 and now it is ₹ 210. The company recently paid dividend of ₹ 8 per share. What is the return a shareholder realized? Using Equation 8.14,

$$K_e = \frac{210 + 8}{180} - 1 = 1.2111 - 1 = 21.11\%$$

Thus, this method would give accurate K_e of the past one year.

Bond yield plus risk premium

Calculation of cost of debt is easier. One can take that as a basis and add premium for the additional risk taken by shareholders to find the cost of equity.

$$K_e = K_d + R_p \tag{8.15}$$

Here, K_d = Pre-tax bond yield

R_p = Risk premium (financing risk premium only)

R_p is essentially the judgement based on the study of variability of income and degree of financial leverage. K_d in this formula should be the pre-tax YTM.

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CAPM approach

Capital asset pricing model (CAPM) is developed for measuring the shareholders' expectation (K_e) based on empirical relationship of return from a particular share and that of market return. CAPM based formula for the cost of equity is,

$$K_e = R_f + (R_m - R_f)\beta_i \qquad (8.16)$$

Here, R_f = Risk-free rate

R_m = Return on market portfolio

β = Systematic risk of the company (covariance of return on firm's share and market return)

The risk premium element in the CAPM approach is calculated based on empirical evidence of variability (β_i) of security *i* with market returns.

For example, β of a company's share is 0.85, market return 21 per cent and risk-free rate 13 per cent. What is the K_e of the company? Using Equation 8.16,

$$K_e = 0.13 + (0.21 - 0.13)\ 0.8$$
$$= 19.4 \text{ per cent}$$

Which method shall we use?

Each method of K_e calculation will give different rates. Which method is more reliable? Read the following suggestions with their logic:

1. Dividend yield approach can be useful in a situation where either (a) the dividend is constant and the share price has remained steady, or (b) the dividends have grown almost at a constant rate. These situations are less likely to be present in reality, rendering the dividend yield models almost useless.
2. Earning-price ratio (or its inverse price-earnings ratio) is useful in determining the value for merger and acquisition. But, for project purposes, it may not be appropriate to use this method as a basis for the cost of equity.
3. Bond yield plus risk premium method is good because the chance of error is limited to the judgement of financing risk premium (R_p) only. One of the few indicators of financing risk premium can be used. Financing risk is indicated by debt-equity ratio, degree of financial leverage, interest-cover ratio (or times-interest-earned ratio) and debt-service-cover ratio.
4. The CAPM based method has at least some empirical evidences of being true. Despite all limitations, the CAPM method is more popular for calculation of the cost of equity. One would notice that the CAPM based cost of equity is often much less than even the cost of debt and may think that CAPM does not give a logical value of cost of equity. CAPM uses the market price of shares and therefore, if we use the market value weight of equity in the WACC calculation, the CAPM based cost of equity will make better sense.

Important points to note

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1. One may read in some literature that the retained earnings have costs and usually less than the cost of equity. Ignore such material because retained earning is a part of equity and market value of equity reflects retaining earning levels.
2. Shall we adjust for the floatation cost when calculating the cost of equity? The answer is NO. Because, the market price of a share will usually factor the upfront costs incurred at the time of issue of share capital.

3. Weighted Average Cost of Capital (WACC or K_o)

After the costs of individual funds are calculated, we need to determine the weights of each source of funds, before we can calculate the weighted average cost of capital.

Weights

- Take all debts at their book value.
- Take equity at market value, if K_e is calculated using CAPM or dividend yield or earning-price method.
- Take equity at book value if bond-yield plus risk premium method is used.

Calculation

Weighted average cost of all funds can be calculated using Equation 8.17,

$$K_o = \frac{K_d W_d + K_p W_p + K_e W_e}{W_d + W_p + W_e} \tag{8.17}$$

Here, W_d = Weight of debt

W_p = Weight of preference shares

W_e = Weight of equity

If there are more than one source of debt with different costs, take the cost of each debt and its weight in the calculation of the weighted average cost of capital.

Example 8.13: WACC calculation

A company's cost of funds and their weights are given as follows:

	Weight	**Cost**
Equity	10 lakh	18.5 per cent
Debt	8 lakh	12.3 per cent
Preference shares	3 lakh	15.6 per cent

Calculate the weighted average cost of capital of this company.

Solution:

Using Equation 8.17,

$$K_o = \frac{(0.185 \times 10) + (0.123 \times 8) + (0.156 \times 3)}{10 + 8 + 3} = 15.724\%$$

Cut-Off Rate (Required Rate of Return) Decision

Now that you have learnt the calculation of cost of capital through cost of debt, equity and weighted average, you will study the concept of cut-off rate. What shall be the cut-off rate (required rate of return) for the project? The different methods prescribed for the determination of cut-off rate are given as follows:

1. Opportunity cost
2. Risk-adjusted discount rate (RADR)
   - Intuitive approach
   - CAPM approach
   - Adjusted WACC approach

Opportunity cost

The required rate of return should be at least equal to the returns from the foregone opportunity (opportunity cost). This is theoretically the best cut-off rate. It is theoretical because in most situations, the opportunity is foregone and its returns are not ascertainable. In addition, the opportunity cost approach does not consider the presence of risk premium in the discount rate of the opportunities.

Cut-off rate or required rate of return (RRR) or risk-adjusted discount rate (RADR)

Risk adjustment is the real issue in the determination of cut-off rate for projects. When the discount rate is calculated after the adjustment for risk, it is called risk-adjusted discount rate, popularly known as *RADR*. A simplistic formula for *RADR* will be as follows:

$$RRR = RADR = R_f + R_p \qquad (8.18)$$

Here, R_f = Risk-free rate

R_p = Risk premium

Four different methods can be prescribed for the RADR calculation. The list of the four methods is as follows:

- Intuitive approach
- Constant share price approach
- CAPM approach
- Adjusted WACC approach

Of these four methods, the last one is the pragmatic approach, strongly recommended for the *RADR* calculation.

Intuitive approach

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In this approach, first the risk-free rate (R_f) is estimated using the prevailing yield on treasury securities and then, the intuitively decided risk premium (R_p) is added into it to get the required rate of return. The intuitive judgement for deciding the risk premium may use the following information:

(a) ***Type of project***: For example, a 3 per cent premium for replacement of machinery, a 5 per cent for expansion, 8 per cent for new product development and 12 per cent for research projects. This method does not consider the effect of new project on the risk profile of business.

(b) ***Other factors***: Other factors may include industry characteristics, debt-equity ratio and degree of total leverage.

CAPM approach

Earlier, we mentioned the capital asset pricing model (CAPM) with reference to cost of equity. CAPM was developed for estimating the investors' required rate of returns from an investment in equity share in the security market. Companies invest in projects and therefore, theoretically, can use CAPM in the project market situation to find the required rate of returns from the project. If risk-free projects (like risk-free securities) exist and their returns are known and if similar projects are available in plenty and if projects have a ready market for trading (like stock and bonds markets), then companies can find the required rate of return using CAPM formula given in Equation 8.16.

$$K_e = R_f + (R_m - R_f)\beta_i$$

Here, R_f = Risk-free rate on risk-free projects

R_m = Return on market portfolio of projects

β = Systematic risk of projects (covariance of return on surrogate firm's project and project-market return)

It should be understood 'if' conditions mentioned shows that project-CAPM is just hypothetical and not practical.

Adjusted WACC approach

We can use weighted average cost of capital as a required rate of return from a new project, if and only if the WACC remains unchanged after the new project is undertaken. However, in most cases of mega-projects, the WACC may change because such projects often change the risk profile of business. If WACC changes with the new project, then we cannot take either pre-project WACC or post-project WACC as a cut-off rate. Follow the steps given below to find the cut-off rate using the adjusted WACC approach:

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Step 1: Calculate WACC before the new project and its financing plan is announced to the market.

Step 2: Announce the new project and its financing plan to the market and allow the market to reprice the share and the bond.

Step 3: Now calculate (a) cost of new bonds that will be issued, using new market price of outstanding bonds (b) cost of equity using the new price of equity shares and finally (c) weighted average cost of capital in the post-project announcement situation. In WACC calculation, include outstanding bonds and debt, proposed new bonds and equity increased with the additional equity funds (irrespective of whether raised through new issue of equity or funded with retained earnings) for financing the project.

Step 4: Now calculate the required rate of return using adjusted WACC approach explained in the following example:

Example 8.14: XY Ltd: Calculating RRR using adjusted WACC approach

XY Ltd has got the gross market capitalization of ₹ 1 crore. Its present *WACC* is 18 per cent. After the company announced new investment plans of ₹ 50 lakh for the next plan period, its cost of capital (*WACC*) went up to 18.5 per cent. Calculate the required rate of return (also known as *RADR*) for XY Ltd's new projects. What would be the *RADR*, if *WACC* had reduced to 17.75 per cent?

Solution:

The required rate of return from the new project of XY Ltd will be as shown in Table 8.11.

Table 8.11 *Required Rate of Return*

Scenario	Size in ₹	Cost of Capital	Earnings Required = Size × Cost of capital
Business-as-is	1,00,00,000	18.00%	18,00,000
Business with new project	1,50,00,000	18.50%	27,75,000
New project	50,00,000	**19.50%**	9,75,000

The answer is $RRR = RADR = \text{Cut-off Rate} = \frac{9{,}75{,}000}{50{,}00{,}000} = $ **19.50 per cent**

If business continues as is, it would require to earn ₹ 18 lakh (18 per cent of ₹ 1 crore) to meet the expectations of funds suppliers, but if the new project is accepted, the firm will have to earn ₹ 27.75 lakh (18.5 per cent of ₹ 1.5 crore). Thus, the business with a new project will have to earn an additional ₹ 9,75,000 (₹ 27,75,000 – ₹ 18,00,000) in return. These additional returns must come from the additional investment in the new project. Thus, the new project must earn at least 19.50 per cent (₹ 9,75,000 ÷ ₹ 50 lakh)

If the *WACC* (K_o) falls from 18 per cent to 17.75 per cent, the RRR from the new project will be as shown in Table 8.12.

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Table 8.12 *RRR from the New Project*

Scenario	Size in ₹	Cost of Capital	Earnings Required
Business-as-is	1,00,00,000	18.00%	18,00,000
Business with new project	1,50,00,000	17.75%	26,62,500
New project	50,00,000	**17.25%**	8,62,500

XY Limited should use the 17.25 per cent discount rate (cut-off rate) for the evaluation of the new project, when K_o has reduced from 18 per cent to 17.75 per cent due to the announcement of investment plan.

In a way, the cut-off rate (required rate of return) based on adjusted weighted average cost of capital uses the following equation:

$$RADR = WACC \pm \Delta R_p$$

Here, ΔR_p indicates differential (change in) risk premium.

Check Your Progress

5. Define erection plan.
6. What is PERT-cost?
7. What are the terms in which financial milestones are described for a project?
8. If time value-based evaluation techniques are used, on which basis is the is the cut-off rate determined?
9. Why is the cost of equity difficult to calculate?
10. What is the intuitive approach for RADR calculation?

8.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Complementary opportunities involve the introduction of new ideas and as such do lead to a certain amount of change in the existing structure.
2. 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.
3. On an average, it takes roughly ten per cent of the total duration of the project for the conceptual stage to be completed.
4. The following tasks are performed during the implementation stage of a feasibility study:
   - Installing the system at the client's location
   - Integrating the system in keeping with the client's technology

- Configuring the system
- Training the users

5. Erection plan is a step-by-step process of putting all pieces together with the stages of testing and experimentations in project design.
6. The technique called PERT-cost attempts to incorporate a cost dimension along with time dimension into the network analysis. This is basically an extension of the approach to planning the time dimension. This helps in developing a critical path that is optimum considering both the time and the cost aspects jointly for planning purposes, as it is supposed to provide cost-time tradeoff.
7. Financial milestones are defined in terms of payback period, accounting rate of return, net present value or internal rate of return and in terms of average interest cover ratio and average debt service coverage ratio, etc.
8. If time value-based evaluation techniques are used, the cutoff rate will be determined on the basis of cost of capital. This involves the calculation of cost of capital.
9. It is most difficult to calculate the cost of equity, because the cash flow obligation associated with the equity is unknown as servicing of equity is not a contractual liability.
10. In the intuitive approach for RADR calculation, first the risk-free rate (R_f) is estimated using the prevailing yield on treasury securities and then, the intuitively decided risk premium (R_p) is added into it to get the required rate of return.

8.6 SUMMARY

- Business opportunity may be defined as an attractive project idea which an entrepreneur accepts as the basis for his investment decision. A business opportunity has two major ingredients: Growing markets and Optimum return on investment.
- Opportunities, according to Drucker, are of three kinds: (i) Additive (ii) Complementary and (iii) Breakthrough.
- Identifying and evaluating opportunities are not easy tasks. The majority of good business opportunities do not emerge suddenly out of the blue; they are actually a consequence of an entrepreneur being alert to the possibilities that might arise, and in a few instances, the consequence of establishing some mechanism for identifying prospective opportunities.
- After gathering a large number of business opportunities, the entrepreneur should consider the following criteria for selecting a particular business opportunity: investment size, location, technology, equipment, marketing, etc.

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- The objective behind the feasibility study is the identification of the probability of one or more solutions that meet the specified business needs. That is, when there is uncertainty about the desired outcome being delivered by the proposed solution, some clarification can be achieved through a feasibility study.
- The stages of a Feasibility Study in normal course of action are:
    1. Conceptual stage
    2. Elaboration stage
    3. Construction stage
    4. Implementation stage
- 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.
- The plan for the project specifies the end product that is desired and in some cases, it may contain considerable details about the components that make the end product. Such information provides the basis for constructing work packages and specifying their contents.
- Project budget has two components in it, cost and cash. Every resource consumed has a cost and cash flow effect. Cash flow has to be tracked with time and cost with activities. Cash flow budget is required for liquidity planning and for obtaining funds in time. Cost of activities is helpful in exercising control over project construction. Cost and cash flow budgets emerge from resource planning and contracting.
- A number of activities with a great degree of variety and interdependence require the firm to organize the activities in the best planned way to avoid any confusion and complications in the execution of the project.
- Conceptually, we can say that a network diagram is a graphical presentation of all the activities of a project, arranged in a proper sequence and with clearly established interdependencies. The network diagram provides a full picture of the project.
- Some steps must be followed for the preparation of a network diagram or critical path model and their application in project management decisions.
- Financial analysis involves detailed calculations to verify financial outcomes of the project. Financial analysis accepts marketing and technical assumptions developed during market analysis and technical analysis and goes further into estimating investment requirements, financing plan, working capital plans and cost estimates for the operations. These financial estimates

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are then used for calculating project cash flow and cost of capital before the financial viability is determined using one or more evaluation techniques.

- Before any financial analysis is carried out, some basic decisions must be in place. These include the period of analysis, a tentative choice of financing mix, cut-off decision and choice of evaluation techniques.
- One important method of determining the cut-off rate is based on the weighted average cost of capital, which in turn needs cost of debt and cost of equity.
- The different methods prescribed for the determination of cut-off rate are given as follows:
  1. Opportunity cost
  2. Risk-adjusted discount rate (RADR)

8.7 KEY WORDS

- **Business opportunity:** It may be defined as an attractive project idea which an entrepreneur accepts as the basis for his investment decision.
- **Feasibility studies:** It refers to the exercises in which the potential solutions of business opportunities or problems are documented.
- **Network diagram:** In the context of project execution, it is a graphical presentation of all the activities of a project, arranged in a proper sequence with clearly established interdependencies.
- **Financial analysis:** It involves detailed calculations to verify financial outcomes of the project.

8.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Give a brief overview of a suitable classification of projects.
2. What is the use of feasibility study?
3. List the tasks generally performed at the conceptual stage of a feasibility study.
4. Mention the information included in the contents of a detailed project report.
5. What are the goals and purposes of network analysis?
6. Write a short note CATS and RATS.
7. Briefly explain the calculation of cost of debt that is not yet issued.
8. What is the calculation of weighted average cost of capital?

Long Answer Questions

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1. Explain the concept of business opportunity identification and selection.
2. Discuss the criteria for selecting a particular business opportunity.
3. Describe the stages of a feasibility study.
4. Examine the concept of project design.
5. Describe the steps involve in network techniques and analysis.
6. Explain the prerequisite of financial analysis.
7. Discuss the steps involved in the process of calculating the cost of debt and equity.
8. Explain the calculation of cut-off rate decision.

8.9 FURTHER READINGS

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BLOCK - III
INSTITUTIONAL DEVELOPMENTS OF ENTREPRENEURS

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UNIT 9 FINANCING ENTREPRENEURS

Structure

9.0 INTRODUCTION

After an entrepreneur has completed the feasibility study, he still needs money in order to make his dream a reality. Project finance means arranging finance to meet the requirements of project expenditure, including start up expenditure. Without project finance the entrepreneur cannot meet the financial requirements of every stage of the project. Finance is needed to acquire fixed assets such as machinery, plant and building as well as working capital to meet the day-to-day operational needs of the project. Venture capital is the promoters' contribution to launch the project work. There are two types of sources to satisfy project finance requirements: internal sources, such as cumulative reserves and other reserves, and external sources, which are issue of shares, debenture and debt from financial institutions. Nationalized banks, Life Insurance Corporation of India, Industrial Development Bank of India (IDBI) and Small Scales Industries Development Corporation

(SSIDC) are some of the financial institutions that are aggressively financing projects. Besides, the entrepreneur raises finance by availing of subsidies, state aid to industries, etc. Project finance, therefore, is crucial to the success of a project.

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9.1 OBJECTIVES

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

- Analyse the different types of financial needs of the project programmes
- Understand the role of different financial institutions to support the financial needs of the projects
- Analyse the role of commercial banks and financial institutions

9.2 INSTITUTIONAL FINANCE TO ENTREPRENEURS

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. Remiting 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

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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.

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

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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 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. Venture capital is the contemporary method of raising finance and hence has been discussed later in this unit in greater detail.

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 flexibiltiy 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.

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9.3 ROLE OF FINANCIAL INSTITUTIONS

In financial economics, financial institutions act as agents providing financial services for their members or clients. Generally, some government authority regulates such financial institutions. Asset management firms, stock brokerages, credit unions, building societies, banks and other similar businesses are some of the common types of financial institutions.

A financial institution functions as an intermediary in the debt and capital markets. It transfers funds from investors to the firms that require them. The flow of funds in an economy is facilitated by it. This is done by pooling the savings so that the risk associated with providing funds for loan is mitigated. This serves as the chief means of developing revenue for depository institutions. In case the yield curve becomes inverse, additional fee-generating services such as prime brokerage and underwriting of securities are offered to these firms.

9.3.1 Industrial Finance Corporation of India (IFCI)

The Industrial Finance Corporation of India (IFCI) was set up in July 1948 by the Government of India under the IFCI Act. Before ICICI was established in 1956, followed by IDBI in 1964, IFCI was the sole institution that implemented the industrial policies initiated by the Government. It has had a significant role to play in modernizing the Indian industry, promoting exports, substituting imports, controlling the level of pollution, conserving energy and generating commercially feasible viable and market-friendly projects. The following are some of the sectors that have enjoyed direct benefits from IFCI:

a. Infrastructure (telecom services, power generation) and the intermediate and capital goods industry (miscellaneous chemicals, synthetic plastics, synthetic fibres)
b. Basic industry (cement basic chemicals, fertilizers, iron and steel)
c. Service industry (hospitals, hotels)
d. Agro-based industry (sugar, paper, textiles)

The IFCI extends financial assistance to the industrial sector through direct subscription/underwriting to debentures/shares and guarantees, by means of rupee and foreign currency loans, and also offers financial services through its facilities of equipment procurement, equipment finance, buyers' and suppliers' credit, equipment leasing and finance to leasing and hire-purchase companies. The financial resources of the IFCI comprise the following three components: (i) Share Capital,

(ii) Bonds and Debentures, and (iii) Other Borrowings.

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The IDBI, scheduled banks, insurance companies, investment trusts and the co-operative banks are the shareholders of the IFCI. Apart from paid up capital and reserves, the major sources of IFCI are issue of bonds and debentures, borrowings from the Government, the RBI, Industrial Development Bank of India and foreign loans.

Some of the popular schemes of the IFCI are as follows:

(a) Interest subsidy scheme for women entrepreneurs
(b) Consultancy fee subsidy schemes for the provision of marketing assistance to SSIs
(c) Encouraging the modernization of tiny, small-scale ancillary units; and
(d) Controlling pollution in the small and medium scale industries.

The IFCI has shown its growing concern in the development of backward districts. Cumulatively, financial assistance of ₹ 462 billion has been sanctioned by IFCI to 5707 concerns and ₹ 444 billion disbursed since its establishment. A central role has been played by IFCI in dispersing industries on a regional basis. Some 2172 units situated in backward regions have received roughly 47 per cent of IFCI's assistance, and been aided in catalyzing investments with a value of more than ₹ 1,206 billion. Women entrepreneurs and self-employed youth too have received assistance from IFCI under the Interest Differential Fund (IDF) and Benevolent Reserve Fund (BRF) schemes.

The following are the functions performed by IFCI for the development of industries:

a. Providing assistance for institutional infrastructure development.
b. Conducting merchant banking operations from its Head Office in New Delhi and a bureau in Mumbai
c. Helping in improving the productivity of various factors of production for the socio-economic growth of the country.
d. Providing technical and administration assistance.
e. Providing guidance in project evaluation, identification formulation, implementation operation etc.
f. Undertaking research and survey for the sake of industrial development.
g. Advancing loans for various purposes such as underwriting of shares, guaranteeing of deferred payments for machinery.

9.3.2 Industrial Development Bank of India (IDBI)

Prior to 1964, there was no apex organization to coordinate the functions of various financial institutions. Then, V.V. Bhatt pointed out that the country needed a central development banking institution for providing 'dynamic leadership in the task of promoting a widely diffused and diversified and yet viable process of industrialization.'[1] It was to fulfill this objective that the Government decided to establish the Industrial Development Bank of India (IDBI).

The IDBI was established on 1 July 1964 under an Act of Parliament as the primary financial institution in the country. Initially, it was set up as a fully owned subsidiary of RBI. In February 1976, it was made into an autonomous institution and its ownership passed from RBI to the Government of India.

IDBI provides assistance to SSIs through its scheme of refinance and, to a limited extent, through its bills rediscounting scheme. As it is not feasible for the IDBI to reach a large number of small-scale industries scattered all over the country, the flow of its assistance to this vast number has been indirect in the form of refinancing of loans granted by the banks and the State Financial Corporations (SFCs).

The IDBI has shown particular interest in the development of small scale industries. Of particular mention is the setting up of the Small Industries Development Fund (SIDF) in May 1986 to facilitate the development and extension of small-scale industries. In 1988, the IDBI also launched the National Equity Fund Scheme (NEFS) for providing support in the nature of equity to tiny and small-scale industries engaged in manufacturing, with a cost not exceeding ₹ 5 lakh. The scheme is administered by the IDBI through nationalized banks. The IDBI has also introduced the 'single window assistance scheme' for grant of term-loans and working capital assistance to new tiny and small scale enterprises. Last, the IDBI has also set up a Voluntary Executive Corporation Cell (VECC) to utilize the services of experienced professionals for counseling small units, tiny and cottage units and for providing consultancy support in specific areas.

During 1987-88, the IDBI sanctioned assistance worth ₹ 1,511 crore to small-scale industries out of total sanction of ₹ 4, 580.60 crore. It means about one-third of total industrial assistance was given to the small-scale sector alone. In order to make the IDBI's coordinating role more effective, the Narasimham Committee[3] has suggested that the IDBI should give up its direct financing function and perform only promotional apex and refinancing role in respect of other institutions like SFCs and SIDBI, etc. The direct lending function should be entrusted to a separate finance company, especially set up for this purpose. IDBI being a financial institution is involved in funding viable projects in different sectors. It has exposure to the textile sector, which is the largest after the steel sector.

IDBI provides the following assistance for the development of industries:

(a) Direct assistance to industrial concerns in the form of underwriting of shares debentures.

(b) Soft loans for modernization, renovation and replacement of existing industry.

(c) Rediscount bills arising out of sale of indigenous machinery on deferred payment.

(d) Financing export-oriented industries.

9.3.3 Industrial Credit Investment Corporation of India (ICICI)[2]

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The ICICI was set up in January 1955 under the Indian Companies Act with the primary objective of developing small and medium industries in the private sector. Its issued capital has been subscribed by Indian banks, insurance companies and individuals and corporations of the United States, the British Eastern Exchange Bank and other companies and general public in India.

ICICI performs the following functions:

i. It provides assistance through direct subscriptions/underwriting to debentures/shares and guarantees as well as by means of offering rupee and foreign currency loans.

ii. It offers a variety of financial services such as deferred credit, leasing credit, installment sale, asset credit and venture capital.

iii. It guarantees loans from other private investment sources.

iv. It conducts techno-economic surveys for backward areas.

v. It provides credit facilities to indigenous manufacturers.

vi. It provides merchant banking services.

The ICICI has set up ICICI Asset Management Company Limited, and has been operating ICICI Mutual Fund since 1993. It also set up two subsidiaries, ICICI Investors Services Ltd., and ICICI Banking Corporation Limited in 1994. The Second Industrial Credit Project for India provides ICICI a second loan of $10 million to replenish its foreign exchange resources. ICICI was created to assist in the development of private industry in India, to encourage local and foreign private capital participation in its financing, and to assist in the expansion of the Indian capital market.

9.3.4 Industrial Reconstruction Bank of India (IRBI)

The Government of India set up Industrial Reconstruction Corporation of India (IRCI) in April 1971 under the Indian Companies Act mainly to look after the special problems of 'sick' units and provide assistance for their speedy reconstruction and rehabilitation. In August 1984, an Act was passed by the Indian Government, which converted the Industrial Reconstruction Corporation of India (IRCI) into the Industrial Reconstruction Bank of India (IRBI).

The following are the various functions performed by IRBI for the development of small scale industries:

1. To function as the primary all-India reconstruction and credit agency for industrial revival, assisting and promoting industrial development and rehabilitating industrial concerns.
2. To extend assistance to sick small-scale units (formerly IRCI had extended assistance to sick closed industrial units in textiles, engineering, and mining industries).

3. To provide consultancy services, merchant banking, hire-purchase and equipment leasing for the rehabilitation of sick industrial units.
4. To help banks and financial institutions assess intrinsic worth of sick units which are seeking assistance for revival.

9.3.5 Small Industries Development Bank of India (SIDBI)

With a view to ensuring larger flow of non-financial and financial assistance to the small-scale sector, the Government of India set up SIDBI under a special Act of Parliament in October 1989 as a fully owned subsidiary of IDBI. The Bank commenced its operations from 2 April 1990 with its head office in Lucknow. SIDBI has taken over the outstanding portfolio of IDBI that relates to the small-scale sector worth over ₹ 4,000 crore. The authorized capital of SIDBI is ₹ 250 crore with an enabling provision to increase it to ₹ 1,000 crore.

The important functions of SIDBI are as follows:

1. To initiate steps for technological upgradation and modernization of existing units.
2. To expand the channels for marketing the products in the SSI sector in domestic and international markets.
3. To promote employment oriented industries especially in semi-urban areas and to create more employment opportunities and thereby check the migration of people to urban areas.
4. To refinance loans and advances extended by primary lending institutions.
5. To discount and rediscount of bills
6. To extend risk capital or soft loan assistance to industries
7. To extend financial support to SSIDC and NSIC

The SIDBI's financial assistance to small-scale industries is channelized through the existing credit delivery system comprising State Finance Corporations, State Industrial Development Corporations, commercial banks and regional rural banks. The SIDBI introduced two new schemes during 1992-93; Equipment Finance Scheme for providing direct finance to existing well-run small-scale units taking up technology upgradation/modernization and refinance for resettlement of voluntarily retired workers of NTC. The other new scheme launched was Venture Capital Fund exclusively for small-scale units, with an initial corpus of ₹ 10 crore. It enrolled itself as an institutional member of the OTC Exchange of India (OTCEI). SIDBI also provides financial support to National Industries Corporation for providing leasing, hire-purchase and marketing support to the industrial units in the small-scale sector.

9.3.6 Life Insurance Corporation of India (LIC)

The Life Insurance Corporation of India (LIC) was established under the LIC Act in 1956 as a fully owned corporation of the Indian Government when the life

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insurance business was nationalized in India. LIC offers a variety of insurance policies to extend social security to various segments of society. It has been deploying its funds in accordance with plan priorities. As per its investment policy, it invests 75 per cent and above of the accretion to its controlled fund in Central and state government securities including government-guaranteed marketable securities and in the socially oriented sectors. It also provides loans for various purposes like housing, water supply, rural electrification, etc. to benefit individuals and groups. LIC also provides term loans and direct subscription/underwriting to the debentures and shares of the corporate sector.

LIC provides the following financial assistance to industries:

a. It liaisons with other all-India financial institutions for providing finance directly to the industries.
b. It provides underwriting support to industrial concerns.

9.3.7 State Financial Corporations (SFCs)

The State Financial Corporation was set up on 28 September 1951 under an Act of Parliament to provide financial assistance to as high a number of small-scale units as possible. The Punjab government took the initiative to set up the first SFC in India in 1953. Today, there are 18 SFCs in the country which exist almost in every State and Union Territory (UT) in India. Of these, 17 were established under the SFCs Act of 1951. The Tamil Nadu Industrial Investment Corporation was set up in 1949 under the Companies Act as the Madras Industrial Investment Corporation and it operates as a full-fledged SFC. The management of the SFC is similar to that of the IFCI. It has a board of directors, a Managing Director and an Executive Committee. A SFC can open its offices in different places within the State.

The following are the main functions performed by SFC for developing industries in the State:

a. To provide long-term finance to small and medium sized industries units
b. To undertake the issue of debentures, bonds, Chares and stock of industrial concerns.
c. To grant loans and advances to industrial concerns that are to be repaid within 20 years.
d. To subscribe debentures floated by the industrial concerns.
e. To grant financial assistance to small road transport operators, hotels, tourism-related activities, hospitals and nursing homes, etc.

9.3.8 Tamil Nadu Industrial Investment Corporation (TIIC)[3]

Tamil Nadu Industrial Investment Corporation Ltd. (TIIC), since its inception in 1949, has been contributing significantly to the industrial development of Tamil Nadu. The main objective of TIIC is to foster industrial development by providing long

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term financial assistance to industries in the state. So far, TIIC has assisted over 100,000 industrial units with a total sanction of over ₹. 70000 crores up to March 31, 2010. In 2017-18 alone, there were sanctions to the tune of ₹ 798.71 crores.

The TIIC has registered a net profit for the seventh consecutive year. The total profit of the Corporation for the financial year 2017-18 was ₹. 25.23 crores as compared to ₹. 147.42 crores in 2008-09.

The Corporation's strategies like quick response and disposal of applications, extensive Customer Meets participated for the management and staff, enhancing product content, fine tuning of interest-rates and quick disbursal of subsidies have helped the companies to overcome the stiff market competition.

TIIC has 6 Regional Offices, 23 Branches, 2 Special Recovery Branches and 4 Field Offices spread all over Tamil Nadu.

Special schemes operated by TIIC

To fulfill the divergent needs/requirements of the industries, TIIC is operating a number of schemes. Some special schemes operated by TIIC include:

- Micro/Small Enterprises Fund Scheme
- Bill Finance Scheme
- Working Capital Term Loan for Rice Mill etc.
- Grow an Entrepreneur Scheme.
- Technology Upgradation Fund for Textile Industries
- Wind Power Projects
- Doctor's Growth Scheme

Case Study

Publishing Entrepreneur, Divya Dubey, Gyaana Books, Fiction For Adults

The success story of Divya Dubey, Delhi-based publishing entrepreneur and founder of Gyaana Books, a trade-book publishing firm which focuses on adult fiction, is worth inspiring hundreds of like-minded youth across the country.

Divya Dubey was one of the finalists at the 2010 British Council's *Young Publishing Entrepreneur Awards*. She started her publishing firm in July 2009. They publish fiction for adults—perhaps the only ones in India to do just that—literary or popular. Their first list was launched on 22 January 2010, at India International Centre in New Delhi. Eminent poet and writer Keki N Daruwalla released three titles. So far they have released six titles (one romance, two murder mysteries, one literary fiction and two short-story collections). Two more literary fiction titles are due for release soon. Gyaana Books work both with new faces as well as established writers.

Divya comes from a family of doctors. Luckily, she discovered her real calling before medicine could claim her! After completing her MA English at St Stephen's College, Delhi, she opted for MA Publishing at Oxford Brookes University, Oxford. To begin with, she started her career as an editor with Sage Publications. It was followed by doing textbooks, trade and graphic novels, before starting her own trade.

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About the challenges faced by them she says:

Several challenges at every front, the greatest being apathy and skepticism – from distributors, retailers, the general public, the media, the literary circles, though things are falling into place very slowly. It is very tough to find acceptance and make a niche for yourself, especially when there are so many big players in the market already. Also, India doesn't have a great reading culture, or let's say book-buying culture (at least not for books in English). Most people run after big brand names and bestsellers – or low-priced books. We're still fighting all or most of that. Publishing – whether for a small firm or for a multinational giant – is a new battle every day – perhaps the only industry that's like that.

Judging success in terms of numbers, they still have to go a long way. However, they have some recognizable names on their lists now comprising Anuradha Kumar, Dipika Mukherjee and Anjana Basu. Their forthcoming title, *Thunder Demons*, has been long-listed for the Man Asian Prize 2009. *Pink Sheep*, gay fiction title, is in fact one of the few books published belonging to this genre. It received great reviews in the mainstream media. Miss Dubey even braved a great risk of self-publishing *Turtle Dove*, her own short story collection. It too got decent reviews in the mainstream media. One of the latest releases, *The Body in the Back Seat* by Salil Desai is already on Landmark's bestseller list.

Questions

1. What has been more influential in deciding Divya Dubey's success as a publisher: her educational background or her business acumen?
2. In what way Gyaana Books stands out from rest of the publishers in the field?

Source: http://www.yourstory.in/

9.4 COMMERCIAL BANKS IN FINANCIAL ROLE

The Scheduled Commercial Banks (SCBs) in the country (300) comprise the State Bank of India (SBI) and its associated banks (8), nationalized banks (19), private sector banks (32), regional rural banks (RRBs) (196) and foreign banks (45). During 1994-95, ten more banks were given the status of SCBs and, Bank of Karad which was taken by Bank of India was excluded. As on 30 June 1999, there were 300 scheduled banks in India with a total network of 64,918 branches.

For a long period, commercial banks did not come forward to extend financial assistance to the small-scale industries because of the SSIs' weak economic base. The first lead in this regard was taken by the SBI, in consultation with the Reserve Bank of India (RBI), in March 1956 by setting up a pilot scheme for the provision of credit for small scale industries. In the beginning, the scheme was confined to nine branches of the SBI which was later extended to all branches of the SBI. The commercial banks started taking the initiative in financing SSIs in a greater way only after the nationalization of banks in July 1969. Normally, the commercial banks provide assistance for working capital requirements of SSIs. Over the years they have also started providing 'term finance as is indicated by the data compiled by the RBI that of all the advances given to SSIs by the commercial banks, the share of the term loan accounted for nearly 30 per cent. A notable feature in the financing of SSIs has been the introduction of the 'Lead Bank Scheme' by the RBI. Under this scheme, each district has been allotted to one scheduled commercial bank for intensive development of banking facilities.

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The introduction of the Credit Guarantee Scheme in 1960 gave a fillip to commercial bank financing to SSIs. Initially, this scheme was introduced in 22 districts on an experimental basis. Later, it was extended all over the country. Further, RBI set up a committee under the chairmanship of Shri P.R. Nayak to look into the adequacy of institutional credit to SSIs. On the basis of the recommendations made by the committee, a special package of measures for financing SSIs was introduced by RBI and banks were advised to take care of sickness in small-sector. Availability of credit to the SSI sector improved further within the sector as the shortfall, if any, was deposited with the Small Industries Development Bank of India (SIDBI).

9.4.1 Appraisal by Bank for Loans

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.

9.4.2 Approaching Financial Institution for Loan

In financial economics, financial institutions act as agents providing financial services for their members or clients. Generally, some government authority regulates such financial institutions. Asset management firms, stock brokerages, credit unions, building societies, banks and other similar businesses are some of the common types of financial institutions.

A financial institution functions as an intermediary in the debt and capital markets. It transfers funds from investors to the firms that require them. The flow of funds in an economy is facilitated by it. This is done by pooling the savings so that the risk associated with providing funds for loan is mitigated. This serves as the chief means of developing revenue for depository institutions. In case the yield curve becomes inverse, additional fee-generating services such as prime brokerage and underwriting of securities are offered to these firms.

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Check Your Progress

1. What is project finance?
2. Mention the need of finance at the inception stage.
3. What is meant by short term and long term finance?
4. What is the role of financial institutions in providing financial assistance to projects? Name some financial institutions that are providing finance to SSIs.

9.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Project finance means arranging finance to meet the requirements of project expenditure including start up expenditure. Without project finance, an entrepreneur cannot meet the financial requirements of every stage of the project.
2. The need of finance in a project starts at the inception stage to meet the start-up expenses such as licensing fee, documentation fee on loans, site registration and stamp duty charges, site development cost, power connection, water supply charges, etc. Finance is also needed to acquire fixed assets such as machinery, plant and building as well as working capital to meet the day-to-day operational needs.
3. Short term need for finance is to meet the day-to-day operations of project. Long term need for finance is for a long period of time and for acquisition of fixed assets.
4. In financial economics, financial institutions act as agents providing financial services for their members or clients. A financial institution functions as an intermediary in the debt and capital markets. It transfers funds from investors to the firms that require them. The flow of funds in an economy is facilitated by it. State Industrial Development Corporations (SIDCs), State Financial Corporations (SFCs), National Small Industries Corporation (NSIC), Small Industries Development Bank of India (SIDBI), Industrial Development Bank of India (IDBI), Industrial Credit Investment Corporation of India (ICICI) and Industrial Finance Corporation of India (IFCI) provide financial assistance to SSIs.

9.6 SUMMARY

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- Project finance means arranging finance to meet the requirements of project expenditure including start up expenditure. It is to meet the financial requirements of every stage of the project.
- Project finance is required to meet both the short term and long term needs of the project. Short term needs are day-to-day operations requirements that are satisfied by working capital. Long term needs are acquiring fixed assets such as machinery, plant and buildings.
- Types of finance are the various ways of making finance available to the project. To know what type of finance satisfies a particular need of project, it requires understanding of the project operations and different activities of project and its span of time and size.
- The sources of finance are broadly classified as internal and external. Internal sources are general reserves, sale of assets, reduction of cost, promoters contribution, etc. These meet the short term financial requirements of project. The external sources are to meet the long term needs of project. Some of the external sources are equity, debt, etc.
- Various financial institutions have been established by the Central Government by Acts of Parliament for the development of industries. Financial institutions are discharging a number of functions and coming up with new schemes from time to time to help women entrepreneurs and regional balance development. These financial institutions are IFCI, ICICI, IDBI, LIC, UTI, SIDBI, NSIC, IRBI, SFC, and SIDC.

9.7 KEY WORDS

- **Angel funding:** A financially sound or wealthy individual who can provide capital for starting a business, generally in return for ownership of equity or convertible debt
- **Chattel mortgage:** A financing option which is suitable for a business that accounts for its operations on a cash basis; its functioning is similar to hire purchase agreements—a series of monthly payments are made by customers, followed by a balloon payment
- **Operating cycle:** The average time between the purchase and acquisition of inventory and the receipt of cash proceeds from it being sold
- **Seed capital:** Securities offering in which one or more parties having certain connections with a novel company invest the financial resources required for starting the business

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- **Debentures:** Certificates of loan agreements given under a company's stamp
- **Venture capital:** Financial investment in a proposal that carries a high degree of risk

9.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Define project finance.
2. What is the need of finance?
3. Write a note on short term finance.
4. What is long term finance?
5. What is receivables finance?
6. Write a note on angel funding.
7. Write a note on hire purchase.

Long Answer Questions

1. What is an external source of finance? Describe the various external sources of finance for project funding.
2. Define venture capital. Describe the various sources and opportunities of venture capital financing.
3. State the need for institutional finance for small enterprises. Which are the institutions providing institutional support to small enterprises/entrepreneurs?
4. Give an account of financial assistance provided by the IFCI to small entrepreneurs/enterprises in India.
5. What are the functions of SIDBI? Discuss the various types of assistance that SIDBI provides to the small scale sector.
6. Write short notes on the following:
   (a) IDBI
   (b) EXIM Bank
   (c) Life Insurance Corporation of India (LIC)
   (d) Unit Trust of India (UTI)
   (e) IRBI
   (f) SFCs

9.9 FURTHER READINGS

NOTES

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[2] Report of the Committee on the Financial System (Narasimham Committee), Government of India, New Delhi, 1991.

[3] **Source:** http://www.tiic.org/aboutus.html

UNIT 10 PROMOTING AN ENTERPRISE

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Structure

10.0 INTRODUCTION

Today, there is a strong institutional network to promote enterprises, particularly the small-scale enterprises.

In this unit you will learn about various national level, state level and other institutions that promote small-scale industries. The unit also teaches reasons and remedies for industrial sickness, government regulations and government incentives and concessions for small scale enterprises.

10.1 OBJECTIVES

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

- Describe the national level and state level institutional networks that are meant to promote SSIs
- Understand the causes of industrial sickness in India
- Discuss the government regulations that are meant to govern the SSIs
- Explore the incentives and concessions offered for small-scale units

10.2 SMALL-SCALE INDUSTRIES (SSI): ROLE AND GROWTH

The turn of the twenty-first century brought in a new service-oriented economy. It was not uncommon for the youth to opt for entrepreneurship. The importance of the small-scale sector can be reflected in a strong institutional network that has evolved for the promotion of small industries in the country. The institutional network can broadly be classified as under (see Figure 10.1).

- Central level institutions/agencies
- State level institutions/agencies
- Other agencies

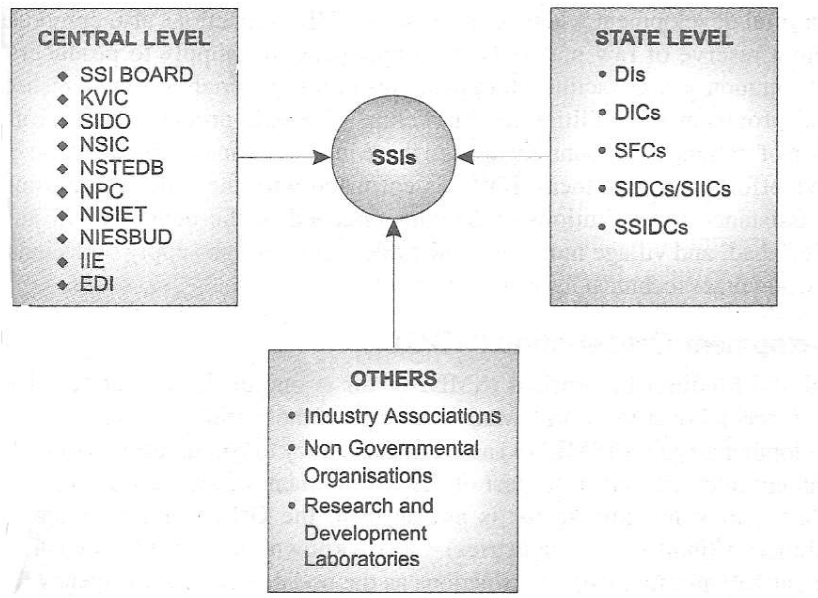

Fig. 10.1 *Institutional Network for Small Scale Industries*

The SSI sector has, over the years, generally recorded a higher growth rate than the industry sector as a whole. This has been achieved over time due to the focus laid by the Government of India on small scale industries. According to the Third All India Census of SSI, there are about 11.86 million small enterprises in the country in 2004-05. These units contribute more than 39 per cent of GDP value added output of the total industrial production in the manufacturing sector. It provides employment to about 28.29 million workers, which is around 80 per cent of the employment in India's industrial sector. In addition, it contributes to nearly 35 per cent of exports. As per NSS 73rd Round (2015-16), there are approximately 633.88 lakha MSME in the country.

The Ministry of Micro, Small and Medium Enterprises is the administrative Ministry in the Government of India for all matters relating to small-scale and village industries. It was established as a Directorate in the Ministry of Industries in the early 1960s, under the Government of India (Allocation of Business) Rules, 1961. It was supervised by a commissioner, with small and medium enterprises as its focus and was converted to the Department of Small-Scale Industries and Agro and Rural Industries in the Ministry of Industry, in 1991, in the wake of economic liberalization. The focus was now only on small scale units. It transformed to the Ministry of Small-Scale Industries and has recently (in May 2007) been merged with the Ministry of Agro and Rural Industries, with a focus on small scale and micro ventures.

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The Ministry forms the administrative framework for MSME. Its vision is to create an enabling policy environment and put in place corresponding support measures to help the sector meet the emerging challenges of competition. It also tries to find ways to harness the opportunities that have arisen due to the accelerating pace of liberalization and globalization of the Indian economy.

Ministry of Micro, Small and Medium Enterprises -initiates appropriate policy measures, programmes, and schemes for the promotion of these enterprises. It is the exclusive agency that formulates the policy framework for the promotion and developing small-scale industries and micro enterprises in the country. The Office of the Development Commissioner (Small Scale Industries) is a part of the Ministry, and is the primary body that is responsible for advising, coordinating and formulating various procedures for the expansion and advancement of the small scale enterprises as well as micro enterprises. The office is also responsible for the communication between the Central Ministries and other Central/State Government agencies/organizations and financial institutions.

It is primarily responsible for designing and implementing policies and programmes, with the help of its field organizations and attached offices. It has setup a network of institutions to offer assistance and to provide a comprehensive range of services and common facilities for its constituents. Also, the implementation of policies and different programmes/schemes directed towards developing the infrastructure and providing support services to small enterprises is carried out through its attached office, i.e., the Small Industries Development Organization (SIDO), it is assisted by other statutory bodies and organizations like the Khadi and Village Industries Commission (KVIC), the Coir Board, and the National Small Industrial Corporation (NSIC).

In addition, institutions have been created to deal with skills relating to human motivation, skills, competencies, creativity, social and economic risks and investment of financial and physical resources of the state. The range of services cover consultancy in techno-economic and managerial aspects, training, testing facilities and marketing assistance through a number of agencies created for the specific services.

These activities are supported by a number of other Central/State government departments, promotional agencies, autonomous institutions, non-government organizations, etc., that provide support in different ways. In addition, District Industries Centres (DICs) have been established in every district of almost all the states of India to primarily focus on entrepreneurship awareness programmes and small scale sector projects.

Check Your Progress

1. List the institutions in institutional network that support small scale industries.
2. Which Act provides the conceptual and legal framework for the industrial development in India?

10.3 REGULATIONS GOVERNING SMALL SCALE INDUSTRIES[1]

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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.

NOTES

(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 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

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 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").

NOTES

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, constitutes 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 sub-section (2D), including the productive capacity of the industrial undertakings and other prescribed particulars.

NOTES

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."

(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.

NOTES

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 regarding 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

NOTES

machinery since then, Government had been considering the question of upward revision of these investment limits.

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 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.

NOTES

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 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

NOTES

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 ad 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. 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

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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 he 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, 19511 (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 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:

NOTES

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 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.

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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.

Notification S.O. 1642(E). – The Central Government in exercise of the powers conferred by Sub-section (1) of Section 7 of the MSMED Act, 2006, after having obtained the recommendations of the Advisory Committee under Sub-section (4) of Section 7 of the Act in this regard, hereby notifies the following enterprises, whether proprietorship, Hindu undivided family, association of persons, co-operative society, partnership or undertaking or any other legal entity, by whatever name called:

(i) in the case of the enterprise engaged in the manufacture or production of goods pertaining to any industry specified n the First Schedule to the Industries (Development and Regulation) Act, 1951 as-

  (a) a micro enterprise, where the investment in plant and machinery does not exceed twenty five lakh rupees:

  (b) a small enterprise, where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees; or

  (c) a medium enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees;

(ii) in the case of the enterprise engaged in providing or rendering of services, as-

  (a) a micro enterprise, where the investment in equipment does not exceed ten lakh rupees;

  (b) a small enterprise, where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees; or

  (c) a medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

Notification S.O. 1722(E) – In exercise of the powers conferred by sub-section (1) of 2006) herein referred to as the said Act, the Central Government specifies the following items, the cost of which shall be excluded while calculating the investment in plant and machinery in the case of the enterprises mentioned in Section 7(1)(a) of the said Act, namely:

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i. equipment such as tools, jigs, dyes, moulds and spare parts for maintenance and the cost of consumables stores;
ii. installation of plant and machinery;
iii. research and development equipment and pollution controlled equipment
iv. power generation set and extra transformer installed by the enterprise as per regulations of the State Electricity Board;
v. bank charges and service charges paid to the National Small Industries Corporation or the State Small Industries Corporation;
vi. procurement or installation of cables, wiring, bus bars, electrical control panels (not mounded on individual machines), oil circuit breakers or miniature circuit breakers which are necessarily to be used for providing electrical power to the plant and machinery or for safety measures;
vii gas producers plants;
viii. transportation charges (excluding sales-tax or value added tax and excise duty) for indigenous machinery from the place of the manufacture to the site of the enterprise;
ix. charges paid for technical know-how for erection of plant and machinery;
x. such storage tanks which store raw material and finished produces and are not linked with the manufacturing process; and
xi. fire fighting equipment.

2. While calculating the investment in plant and machinery refer to paragraph 1, the original price thereof, irrespective of whether the plant and machinery are new or second handed, shall be taken into account provided that in the case of imported machinery, the following shall be included in calculating the value, namely;
    i. Import duty (excluding miscellaneous expenses such as transportation from the port to the site of the factory, demurrage paid at the port);
    ii. Shipping charges;
    iii. Customs clearance charges; and
    iv. Sales tax or value added tax.

Case Study

Akshaye Madhok, Director of Geek Online Ventures, a trend-setter in 'interactive' entrepreneurship

'Interactive' entrepreneur Akshaye Madhok managed to start one of India's freshest digital creative agencies after getting an education in hotel management! Well, that sings a eulogy for the spirit of entrepreneurship. He was one of the finalists at the British Council's Young Interactive Entrepreneur Awards.

Geek as a digital creative agency offers brand-led creative solutions to youth-oriented mass brands in the country. They focus on telling compelling stories and creating meaningful conversations on behalf of the brand. Akshaye finished

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his hotel management degree in 2003 and entered the field of digital advertising. At that time 'digital' stood for websites only. There was hardly any social media. Just imagine, even web banners did not exist. Most of the players simply made websites. At this juncture, he got the opportunity to work with Nagesh Manay of Opus CDM. They did some great work for clients such as 3M, Stanley Boutique, etc. He was actively involved in the planning and development of marketing strategy as well.

After spending some time at Opus CDM, he worked as a freelancer for some years. Afterwards he started Interactive Broadcasting in 2007. Presently his firm has two offices: one in Bangalore and the other in Mumbai. They have clients such as Durex, Kingfisher, Manipal University, etc. During 2010, they clocked in about Rs. 80 lakhs in revenues. This year, they expect it to rise to Rs.1.5 crores. To make it more encouraging for them, they were awarded the global branding responsibilities for Recruitment Factory. This firm had initially approached them for social media strategy. However, they didn't possess any brand guidelines. So, Mr. Madhok started from scratch and provided them a logo, tagline and a branding template which could be used globally.

Presently, they do website development, web banners, social media experiences and games. However, they are moving towards an integrated communications approach. In fact they want to be the first digital agency to enter the mainstream.

For aspiring entrepreneurs he has the word of advice:

I'd advise them to hold on to the control of their organization. If you have an interesting idea, there will be a lot of people interested in buying you out or at least, grab equity. But if you have faith in your concept, you should hold on and you will definitely get to reap the benefits of that decision.

Questions

1. What do you understand by interactive entrepreneurship?
2. What do you mean by 'integrated communications approach'?

Source: http://www.yourstory.in/

10.4 INCENTIVES AND CONCESSIONS GOVERNING SMALL SCALE INDUSTRIES

In this section, you will study the incentives and concession giverning small scale industries.

Central and state level incentives for small scale industries

Generally, the following incentives are offered by the Centre to promote small scale industries:

- Credit prescription (i.e., priority sector lending) and differential rates of interest
- Excise Exemption Scheme
- Exemption under Direct Tax Laws
- Statutory support like reservation and the Interest on Delayed Payments Act.

Notably, the Excise Law, Banking Laws and the Direct Taxes Law have included the word SSI in their exemption notifications; however, in some cases they may define it in a different manner. Nevertheless, usually the registration certificate issued by the registering authority is taken as proof of belonging to the SSI category.

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To boost the growth of SSIs, states/UTs have devised their own packages of facilities and incentives. Such measures comprise tax subsidies, development of industrial estates, power tariff subsidies, capital investment subsidies and various other incentives. In principle, both the Centre and the States, whether under law or otherwise, focus their incentives and support packages usually to units registered with them.

Such concessions and incentives may comprise:

- Excise exemptions
- Income-Tax exemption and Sales Tax exemption as per the state government policy
- Incentives and concessions in power tariff, etc.
- Providing price and purchase preferences for goods produced
- Making available raw material on the basis of existing policy

Incentives for small scale industries in backward, tribal and hilly areas

The Indian Government put special emphasis on the industrial development of backward, tribal and hilly areas in most of the Five Year Plans as well as industrial policy statements. As the development of backward areas is a multifaceted and long-term process, various committees have been appointed to identify the backward areas and set up criteria and schemes to ensure balanced regional development. Presently, both the States and the Centre provide various types of incentives and concessions to start SSIs in the specified backward areas.

The main objective of starting integrated rural development programme is to develop backward areas. The Indian Government's rural industries project programme was aimed at developing units in designated rural areas. Although the backward areas development programmes differ from state to state, yet these programmes represent a noteworthy package of incentives to bring industries to the backward areas. Following are some of the common incentives provided to small scale industries in the rural areas:

- **Land:** Most of the states have constituted specific areas with infrastructure for setting up of industries. However, the terms and conditions may differ across states. For example, some states may not charge rent during the starting years, while others allow payment in installments.
- **Power:** Generally, electricity is provided at the subsidized rates of 50 per cent, while some states exempt such units from payment to begin with.
- **Water:** Usually, water is supplied on a no-profit, no-loss basis or with 50 per cent concession on water charges for a time period of 5 years.
- **Sales tax:** Industries are exempted from sales tax in all union territories, while some states provide exemption for 5 years.

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- **Raw materials:** The units which are located in backward areas are provided favoured treatment regarding the allotment of scarce raw materials such as cement, iron and steel, etc.
- **Finance:** For building capital assets, a subsidy of 10–15 per cent is provided. Further, loans are also provided at subsidized rates of interest.
- **Industrial estates:** Some states encourage setting up of industrial estates in backward areas.
- **Tax holiday:** Tax exemptions for 5–10 years are provided to industries set up in backward, hilly and tribal areas.

In conclusion, the Indian Government is offering special support to the small scale industries through various institutions. Unfortunately, despite special attention the rate of development is still slow and imbalances exist in the backward and hilly areas. Deficient infrastructural facilities in these areas is one of the key reasons for backwardness. We need to fastly develop infrastructure facilities in such areas, as no amount of subsidies or concessions can work in the absence of such facilities.

10.5 SICKNESS IN SMALL INDUSTRIES

Industrial sickness is a chronic problem with many traditional and modern industries facing persisting problems of stagnation obsolescence and losses.

10.5.1 Causes and Remedies for Industrial Sickness

Industrial development is essential to attain economic growth. However, industrial sickness has become an almost unavoidable feature. Industrial sickness occurs for various reasons and results in wastage of capital and other resources sick units heavy cash losses and cannot generate internal surplus on a continual basis. There are different forms and degrees of industrial sickness.

Various causes for industrial sickness can be classified as follows:

Internal causes

The following internal causes may lead to sickness of an industrial unit.

1. ***Planning and implementation stage***

   A. *Technical feasibility*
   - Inadequate technical know-how
   - Locational disadvantage
   - Outdated production process

   B. *Economic viability*
   - High cost of inputs
   - High breakeven point
   - Uneconomic size of project
   - Underestimation of financial requirements
   - Unduly large investment in fixed assets

- Overestimation of demand
- Cost over runs resulting in delays in getting licence/sanctions, etc.
- Inadequate mobilization of finance

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2. ***Commercial production stage***

A. *Production management*

- Inappropriate product- mix
- Poor quality control
- Poor capacity utilization
- High cost of production
- Poor inventory management
- Inadequate maintenance and replacement
- Lack of timely and adequate modernization
- High wastage

B. *Financial management*

- Poor resource management and financial planning
- Faulty costing
- Liberal dividend policy
- General financial indiscipline and application of funds for unauthorized purpose
- Deficiency of funds
- Overtrading
- Unfavourable gearing or keeping adverse debt-equity ratio
- Inadequate working capital
- Absence of cost consciousness
- Lack of effective collection machinery

C. *Labour management*

- Excessively high wage structure
- Inefficient handling of labour problems
- Excessive manpower
- Poor labour productivity
- Poor labour relations
- Lack of trained/skilled labour or technically competent personnel

D. *Marketing management*

- Dependence on a single customer or a limited number of customers
- Dependence on a single or a limited number of products
- Poor sales realization
- Defective pricing policy
- Booking of large orders at fixed prices in an inflationary market
- Weak market organization
- Lack of market feedback and market research

- Lack of knowledge of marketing techniques
- Unscrupulous sales/purchase practices

E. *Administrative management*

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- Overcentralization
- Lack of professionalism
- Lack of feedback to management
- Lack of proper management information systems
- Lack of timely diversification
- Excessive expenditure of R&D
- Divided loyalties
- Dissension within management
- Incompetent management
- Dishonest management

External causes

The external factors that cause industrial sickness can be classified as follows:

1. ***Infrastructural problems***
   - Non-availability of irregular supply of critical raw materials or other inputs
   - Chronic power shortage
   - Transport barriers
2. ***Financial problems***

   A. *Government controls*
   - Government price controls
   - Fiscal duties
   - Abrupt changes in government policies affecting costs/prices/imports/exports/licensing
   - Procedural delays on the part of the financial/licensing/other controlling or regulating authorities
3. ***Market constraints***
   - Market saturation
   - Technological obsolescence
   - Recession fall in domestic/export demand
   - Non-availability of adequate finance at the right time
4. ***Extraneous factors***
   - Natural calamities
   - Political situation (domestic as well as international)
   - Sympathetic strikes
   - Multiplicity of labour unions
   - War

The objective of any revival programme should be to improve the capacity of the industry to generate an internal surplus. In view of various factors affecting a sick industry, the following aspects should be covered in a comprehensive revival programme:

1. All strengths of the industry should be identified and availed, while all weaknesses should be eliminated.
2. The new break-even level of operations should be determined and it should be ensured that it is substantially lower than the previous break-even point.
3. The feasibility of the industry should be established in order to operate in the prevailing business environment.
4. The amount of funds required to operate at the above operating level should be determined.
5. In addition to the existing commitments of the industry in terms of liabilities to suppliers, liabilities to government lending institutions, banks, etc. have to be accurately estimated and incorporated in the revival plan.

The revival plan is drafted after incorporating the above-mentioned details, clearly indicating that results can be expected over a period of time. The plan should also have some built-in indicators of key performances, for close monitoring.

Check Your Progress

3. How did the Indian government work towards the development of backward areas?
4. Define industrial sickness.

10.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The institutions in institutional network that support small scale industries include (i) Institutions at the central level: SSI Board, KVIC, SIDO, NSIC, NSTEDB, NPC, NISIET, NIESBUD, IIE, EDI, etc.; (ii) State level: DIs, DICs, SFCs, SIDCs, SIICs, SSIDCS, etc.; and (iii) Others include Industry associations, NGOs, R&D labs.
2. 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.
3. Government of India laid special emphasis on the industrial development of backward, tribal and hilly areas in all the Five Year Plans and industrial policy statements. Since the development of backward areas is a complex and long-term process, several committees have been appointed to identify the identifying backward areas and define criteria and schemes for the

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balanced regional development. States and Centre offer several incentives and concessions to set up SSIs in the backward areas.

4. Industrial sickness is the failure of the organization to achieve its goal of economic success on continual basis. It is marked with wastage of resources, financial losses, and failure to fulfil its obligations towards its stake holders including customers, channel partners, employees, and business partners.

10.7 SUMMARY

- The institutional support network for small scale industries can broadly be classified as: (i) Central level institutions/agencies, (ii) State level institutions/ agencies, and (iii) Other agencies.
- 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.
- Generally, the following incentives are offered by the Centre to promote small scale industries:
    - Credit prescription (i.e., priority sector lending) and differential rates of interest
    - Excise Exemption Scheme
    - Exemption under Direct Tax Laws
    - Statutory support like reservation and the Interest on Delayed Payments Act.
- Government of India laid special emphasis on the industrial development of backward, tribal and hilly areas in all the Five Year Plans and industrial policy statements. Since the development of backward areas is a complex and long-term process, several committees have been appointed to identify the identifying backward areas and define criteria and schemes for the balanced regional development.
- Industrial sickness is a chronic problem in India with several industries suffering from stagnation and losses. Industrial sickness can be due to using outdated technology, inability compete in the market, labour problems, poor capacity utilization, and so on. An effective revival programme can help to restore the sick units.

10.8 KEY WORDS

- **Tax holiday:** Exemption provided by the government to industries established in backward, hilly and tribal areas from paying taxes
- **DICs:** District Industries Centres provide support facilities, concessions and services to develop tiny, cottage and DICs small scall units.

10.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. List the institutions in the institutional network to support small scale industries.
2. Write a note on how the institutional network provides the necessary support to small scale industries.
3. Write a note on incentives and concessions given to the backward areas.

Long Answer Questions

1. Explain in detail the conceptual and legal framework for industrial development and industries in India provided by the Industries (Development and Regulation) Act, 1951.
2. Explain in detail the causes and remedies for industrial sickness.

10.10 FURTHER READINGS

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Khanka, S.S. 1999. *Entrepreneurial Development.* New Delhi: S. Chand & Company.

Kumar, Anil S. et al. 2008. *Entrepreneurship Development*. New Delhi: New Age International Publishers.

Endnote

[1] 'The Industries (Development and Regulation) Act, 1951', available on www.vakilno1.com/bareacts/industriesdevact/s11b.htm, access date 8.06.2011.

UNIT 11 INSTITUTIONAL DEVELOPMENT OF ENTREPRENEURS

Structure

11.0 INTRODUCTION

Small scale industries have the potential to attract the maximum amount of skill and entrepreneurial talent in the country and have become a factor for promotion of economic democracy. This they do by allowing profits from industrial growth to be distributed over a broader section of the people. That is how they came to acquire a prominent place in the development plan of most countries. Hence, promotion of small manufacturing enterprises has been one of the main strategies of economic development in developing countries.

Separate agencies are required to understand various problems such as guidance, finance and technology in promotion and development of small scale industries. This unit focuses on the need for support to entrepreneurs, and the support provided by DIC, SIDBI, SIDCO, SSIB, NSIC, SISI, DICs and other institutions. It also examines the promotion of entrepreneurs through various schemes.

11.1 OBJECTIVES

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

- Understand the need for support agencies
- Describe the role of the District Industries Centre in industrial support and development
- Explain the significance and functions of various support agencies such as SIDBI, SIDCO, SSIB, NSIC and SISI
- Understand the various schemes launched by the government to promote entrepreneurship

11.2 ROLE OF SUPPORT AGENCIES

Global economic slowdown has resulted in nearly two lakh small and medium enterprises (SME) throughout India facing the danger of ending up as sick units by 2009–10, according to Chandrakant Salunkhe[1]. Approximately 1.14 lakh SME were declared sick in 2007–08 and it was probable that the number would go up in the following fiscal year. Overseas clients in Europe and North and South America were cancelling their orders with SME units, the impact of which was likely to be felt more after March 2009. He also said that sectors such as equipment manufacturers, food manufacturing and processing and auto components would be the worst sufferers. Analysing the problems faced by companies during recession, he stated that SMEs were also having to face other obstacles such as lack of information and knowledge regarding the variety of schemes announced by RBI and the Government, lack of marketing assistance and lack of funds. He further drew attention to the Indian SME segment employing, on an average, one million persons annually, and which would probably encounter more layoffs in the following fiscal year.

In spite of RBI and the Government announcing numerous measures for providing more loans to the SME section, it has been observed that frequently, at the grass root level, banks and financial institutions remain unaware of such schemes and fail to guide and support the entrepreneurs.

Though economic recession in the fiscal year 2008–09 may be one of the causes for two lakh SMEs throughout India being in danger of ending up as sick units, there are other factors to be considered such as lack of support. Enterprises need consistent support for development. The Government of India has realized this and promoted a number of entrepreneurial support agencies and banks. However, it is clear that the existing support is not enough. Entrepreneurship needs maximum support and guidance from separate institutions and government agencies for purposes of:

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1. Selection of industry
2. Location of plant
3. Procurement of raw material
4. Determination of size of manpower requirement (skilled, semi-skilled and un-skilled)
5. Generation and management of working capital
6. Knowledge of marketability of goods and services
7. Knowledge of sales tax and central tax
8. Knowledge of bookkeep and accountancy
9. Knowledge of transportation and warehousing facilities
10. Knowledge of licensing and Government permissions

Overview of Support Agencies

Small Scale Industries is a comprehensive term used to refer to the manufacturing activity carried out in relatively small establishments. Smallness refers to the scale of operations of the industry. Small industries constitute a central part of the industrial structure of both developed and developing countries in view of their capacity to provide lucrative employment opportunities and contribute to the production of goods and services. Small Scale Industries use indigenous technology and provide employment opportunities to the local people. This is done with a view to avoiding the augmentation of industries and controlling the migration of people. These industries also help in equal distribution of income and wealth. Small-scale industries have the potential to attract the maximum amount of skill and entrepreneurial talent in the country and become a factor for promotion of economic and social equality, by allowing profits from industrial growth to reach a diverse section of the people. That is how small scale industry came to acquire a prominent place in the growth plan of developed and developing countries. In developing countries like India promotion of small scale enterprises has been one of the main strategies for economic development.

By and large, small industries are mostly individual enterprises that provided all goes well with them and they show healthy and sustained growth, ultimately mature into public institutions and promote national development. Whereas individuals cannot obviously finance small-scale industry growth effectively, financing of small industries has always been a complex problem in most countries and has attracted the attention of bankers, industrialists, economists, governments and financial institutions. The main financial problems of small industries may be categorized as follows:

1. Lack of promoter's capital
2. Fewer alternatives for obtaining short-term loans
3. Complexity in obtaining long-term loans to supplement insufficient equity capital

Various policies have been adopted by developing as well as highly industrialized countries to overcome these problems. Banks and stock exchanges are better organized, various special financial institutions have been established, international financial institutions and foreign private capital are assigned a greater role and government is also taking greater interest in this sector.

Small enterprises require finances in various stages of developing a business idea into a production or service unit. Small industries invariably experience chronic shortage of working funds in the production stage because of insufficient short term funds. Financial requirements could be classified into tangible and intangible investments. Tangible investment comprises current assets and fixed assets. Current assets are normal cash balance, inventory, customers' accounts and miscellaneous current assets. Fixed assets include furniture and fixtures, tools, machinery and equipment, land and building, and other miscellaneous fixed assets. Intangible investment is required for promotional expenses, organizational expenses, operating losses other than depreciation up to the time when the business will be financially self-sustaining, cost of financing as also intangible assets such as patents, goodwill and copyrights purchased for cash.

Estimating a small industry capital expenditure requirement is not easy; assumptions have to be made under conditions of great uncertainty. The cost of capital in a small industry is relatively high. The total capital requirement depends upon the type of business. The quantum of working capital needed is usually dependent upon the length of the period of manufacture, the cost of the product, rate of turnover of inventory and also seasonal fluctuations. Small Scale Enterprises not only need financial assistance but also need support and guidance from government agencies, to bring their idea into reality and to run the enterprise profitably. 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 in Small Scale Industries promotion and development.

11.2.1 District Industries Centre (DIC)

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.

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

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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.

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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.

11.2.2 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 outstand-ing 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 (lID) 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

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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 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-Em-ployment 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.

11.2.3 Small Industries Service Institute (SISI)

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 Institues). There are close to 30 MSME-DIs in the country as of 2018. The major functions of SISI are:

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.

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- 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.

11.2.4 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.
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.

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5. **Hire purchase and equipment leasing scheme:** Under this scheme, SIDCO provides a package assistance of the allotters 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 allotter after he has paid the last installment.

11.2.5 Major Schemes of 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 polices 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.

(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

11.2.6 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.

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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.

11.2.7 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.

11.2.8 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.

(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

11.2.9 Industrial and Technical Consultancy Organisation of Tamil Nadu Limited (ITCOT)[2]

Industrial and Technical Consultancy Organisation of Tamil Nadu Limited (ITCOT), was incorporated as a company under the Companies Act, 1956, on 17 July

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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
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.

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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.

11.2.10 Entrepreneurial Guidance Bureau[3]

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.

Case Study

Entrepreneur and Cardiologist Dr. Ravindra Kulkarni founder of Just For Hearts, a wellness and lifestyle consultancy with a difference!

These are stressed up times. However, there is a silver lining. Pune based organization *Just For Hearts* is helping companies and individuals to de-stress to feel better both at the physical and psychological levels. They provide an array of services like various necessary screening tests, awareness programs, risk assessment, Yoga consultation, diet counseling, cardiac consultation, treatment and post treatment rehabilitation. They have also introduced unique concepts such as Office Yoga, which are specific to stressful corporate environment. There were many things which led Dr. Ravindra to launch *Just For Hearts*. In India, people are basically disease centered; while nobody emphasizes upon health and wellness. There is an urgent requirement to refine such practices. Just look around, and you will find that people do not have options for lifestyle consultancy and wellness. Further, there is a tremendous increase in the occurrence of lifestyle diseases like heart ailments, etc. These have a great impact on the lives of individuals and their families. Hence, the need for *Just For Hearts*.

Born and brought up in Satara, Maharashtra, Dr. Kulkarni's schooling was done in the vernacular medium. Nonetheless, he finished his graduation and post-graduation medical qualifications with merits from University of Pune. Afterwards, he went on to get cardiology trainings at several universities in USA and Italy. Presently, he is also consultant cardiologist at several hospitals in Pune.

The greatest challenge is to make people aware of the need and urgency in this field. It is a fact that a so-called healthy individual does not come forward for a health test. However, the results can be shocking. The simple fact that there has been a massive increase in the cases of heart diseases among people in their 20s and 30s is sufficient to substantiate this hard reality. Tragically, almost in all the cases, they are caught off hand. The biggest challenge is to break the traditional mind set that heart diseases are for the elderly only. Further, for an organization like *Just For Heart* there can be another challenge in that it may be miss-interpreted as a charitable organization. The reason is that they try to get involved at the preventive stage, when a normal person does not suspect anything wrong with his heart and lifestyle. Only when there are symptoms, he realizes the importance of being pro-active towards his health.

Elaborating on the challenges faced by his organization, Dr. Ravindra Kulkarni says:

Being a cardiologist and leading Just For Hearts, I believe we are the one-stop solution for all 'matters of the heart'! Hands on experience in dealing with critical patients and unique cases have helped us design a holistic approach to heart care. With our expertise, we can reach out to people with their individual risk assessment, screening tests, preventive care, treatment and even post-treatment rehabilitation. My participation in international researches in cardiology and clinical drug trials have helped in the understanding of newer modalities of heart treatment. As an up-to-date team, thus we are able to serve better.

About the outreach model of the organization, he has to say:

Along from the on-field activities that we do, we focus a lot on interacting with people through social media. Our Facebook page is a daily dose on health, heart and lifestyle management. We also have frequent online sessions on heart care where the experts answer queries in real time. People have been increasingly participating in relevant conversations with us. Our blog is also an active tool that connects us to them.

Questions

1. What are the main challenges faced by an organization like *Just For Hearts*?
2. Elaborate upon the unique idea behind the setting up and success of Dr. Ravindra's organization.

Source: http://www.yourstory.in/

Check Your Progress

1. Why do small scale industries play a prominent role in the economic development of a country?
2. What are the advantages in promoting small scale industry
3. Why should support agencies promote and develop entrepreneurship?

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11.3 INCENTIVES AND SUBSIDIES TO ENTREPRENEURS: PROBLEMS AND PROSPECTUS

In this section, you will study problems and prospects for entrepreneurs through subsidies.

State Capital Investment Subsidy

In order to encourage setting up of industrial units in their States, State Governments provide State Capital Investment Subsidy to Priority Sector industries. The facilities are available in Uttar Pradesh, Jammu & Kashmir, Andaman & Nicobar Islands., Sikkim, Karnataka, Meghalaya, Himachal Pradesh, Gujarat, Punjab, Andhra Pradesh, Kerala, Maharashtra, Tripura and Manipur.

Sales Tax concessions

State Governments give concessions in sales tax to new units/sick units on the sale of their finished products at the first point of sale for a period of three to fifteen years. The facilities are available in Uttar Pradesh, Jammu & Kashmir, Sikkim, Daman & Diu, Karnataka, Meghalaya, Himachal Pradesh, Gujarat, Nagaland, Punjab, Rajasthan, Andhra Pradesh, Kerala, Haryana and Tripura.

Exemption from stamp duty and local taxes

State Governments exempt stamp duty in respect of land allotted by the Government to the new industrial units. Machinery, equipments, raw materials and packing materials of new units are exempted from payment of octroi duty and other local taxes. The facilities are available in Jammu & Kashmir, Sikkim, Daman, Karnataka, Meghalaya, Gujarat, Nagaland, Rajasthan, Haryana, Maharashtra and Manipur.

Rebate in electricity charges and water charges

State Governments provide rebate in electricity charges and water charges to the new and existing units in their respective States. The facilities are available in Sikkim, Daman, Karnataka, Himachal Pradesh, Gujarat, Nagaland, Rajasthan, Andhra Pradesh, Kerala and Maharashtra.

Interest Subsidy

State Governments provide interest subsidy to entrepreneurs on term loans which they get from State Financial Institutions/Scheduled Banks. The facilities are available in Jammu & Kashmir, Andaman & Nicobar Islands, Sikkim, Meghalaya, Himachal Pradesh, Punjab, Rajasthan, Andhra Pradesh and Manipur.

State Transport Subsidy

Some State Governments provide State transport subsidy at notified rates from time to time to industrial units on transportation of raw materials and finished products. The facilities are available in Jammu & Kashmir, Andaman & Nicobar Islands, Nagaland and Manipur.

Subsidy for technical know-how

State Governments provide subsidy on the cost of technical know-how obtained by small scale industries from reputed and well established research and development organizations. For obtaining such technical know- how, prior permission from State Governments has to be obtained. The facilities are available in Jammu & Kashmir, Sikkim, Delhi, Kerala and Manipur.

Marketing Support

The State Government Departments, Semi-Government Organizations, Autonomous Government Organizations, Grant-in-Aid Institutions, Departmental Undertakings, etc. while making purchases of their requirements of store items, give preference to the products manufactured by the local SSI units. The facilities are available in Jammu & Kashmir, Sikkim, Nagaland, Delhi, Kerala, Manipur and Tripura.

Special facilities for export oriented un4ts

State Governments provide special package of incentives and better infrastructural facilities for export oriented units. State Governments reimburse costs incurred by SSI units for shipment of export samples from the nearest port/container depot to the port of destination. The facilities are available in Uttar Pradesh, Karnataka, Himachal Pradesh, Punjab, Rajasthan and Tripura.

Air Freight Subsidy

State Governments provide Air Freight Subsidy to SSI units on their finished goods for any destination. The facilities are available in Uttar Pradesh.

Incentives to Non-Resident Indians (NRIs)

State Governments provide special incentives for setting up new industries by NRis in their respective States. The facilities are available in Uttar Pradesh, Himachal Pradesh, Purjab and Rajasthan.

Special incentives for Women

SSI units owned and managed by women entrepreneurs having more than 80 per cent women labourers are provided special incentives like 50 per cent subsidy for building and machinery, rent subsidy, managerial grant, stipendary training, etc. The facilities are available in Tripura and Kerala.

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11.4 DEVELOPING WOMEN AND RURAL ENTREPRENEURS: ENTREPRENEURIAL MOTIVATION

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.

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

NOTES

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 Udyog Nidhi Scheme was introduced by IDBI 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.

Shri Shaki Package is a scheme run by State Bank of India to provide special training and concessions 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 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 etwork.

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.

In the New Industrial Policy of 1991, the government stressed the need for conducting special entrepreneurship programmes for women with a view to develop women entrepreneurship. The policy has recommended that product and process oriented courses may be conducted to enable women to start small-scale industries.

One lakh women entrepreneurs were trained in trade-related activities under the initiation of the Ministry of Small Scale Industry. Six project lines including food, forest produce collection, leather, readymade garments and coins have been selected which would focus on women entrepreneurs. Thus, the climate is ideal for women in India to become 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.

NOTES

Regional Rural Banks are major investors in different types of operations in the rural areas. They are supported by the National Bank for Agriculture and Rural Development (NABARD), which was established as the premiere rural development bank. NABARD performs an essential function of promoting rural welfare in order to achieve institutional development, aiding refinance to loan providers in the rural sector.

The evolution of rural banking in India can be traced back to the very inception of the banking sector in the country.. In the multiagency approach to provide credit to agriculture, Regional Rural Banks (RRB's) have special place. They are state sponsored, regionally based and rural oriented commercial banks. These banks were set up with the purpose of facilitating the promotion of rural business in India.

Rural banks provide credit for the development of small scale industries, handicrafts, rural crafts, village industries, cottage industries, agriculture, etc. They also support all other related economic operations in the rural sector, promotion of sustainable growth in the rural sector. A regional rural bank is jointly owned by the government of India, the government of concerned state and public sector bank, which sponsored it. The authorized capital of each bank is ₹ 10 million and the issued capital is ₹ 2.5 million; which is held by them in the proportion of 50, 15 and 35 per cent respectively. Each bank comes into being through a government notification and conducts banking business within the local limits specified by the notification.

Rural Banks are spread all across the country and have been playing an important part in the development and growth of the rural business and economy. The development of the rural sector is important for the economic growth of India. As India is an agrarian economy, the growth of the rural sector and the promotion of agricultural sector would give the economy a boost.

The State Bank of India is one of the major commercial banks having regional rural banks. There are 30 regional rural banks in India, under the State Bank of India and it is spread in 13 states across India. The number of branches the SBI Regional Rural Banks is more than 2000. Several other banks, apart from the State Bank of India also functions as the promoter of rural development in India.

Check Your Progress

4. What are the main financial problems facing the small scale industry?
5. List the various activities of SIDCO.
6. What is the major function of SSIB?
7. Describe the functions NSIC.

11.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. Small-scale industries have the potential to attract the maximum amount of skill and entrepreneurial talent in the country and become a factor for promotion of economic democracy, by allowing profits from industrial growth to be distributed over a broader section of the people. That is how it came to acquire a prominent place in the development plan of these countries. Hence, promotion of small manufacturing enterprises has been one of the main strategies of economic development in developing countries.
2. Small-scale units help to decentralize industry, to spread entrepreneurship and to develop local resource endowment. It neutralizes the augmentation of industrialization, and steers a balanced regional development. This sector also helps in creating employment opportunities on dispersed basis, bringing about more equitable distribution of income and wealth. By and large, small industries are mostly individual enterprises that normally mature into public institutions and promote national development.
3. Support agency is an organization working under Central or State Government to facilitate various services which are needed for entrepreneurial promotion and development, such as selection of industry, location of plant, procurement of raw material, determination of size of manpower requirement (skilled, semi-skilled and un-skilled), generation and management of working capital, marketability of goods and services, knowledge of sales tax and central tax, knowledge of bookkeeping and accountancy, transportation and warehousing facilities, licensing, and government permissions.
4. The main financial problems of small industries may be categorized as follows: i) lack of promoter's capital, ii) fewer alternatives for obtaining short-term loans, and iii) complexity in obtaining long-term loans to supplement insufficient equity capital.
5. The State Industries Development Corporations were set up in various states under the Companies Act, 1956 to provide primary development needs of tiny, small, village and cottage industries. SIDCO has been working actively since its inception and is engaged in the following: (a) Industrial Estate Design and Promotion (b) Providing Marketing Assistance (c) Working as Recognized Export House (d) Ensuring Balanced Regional Development and (e) Providing Hire Purchase and Equipment Leasing Scheme.
6. In 1954, the Government of India constituted the Small Scale Industries Board (SSIB), which is the apex body constituted for advising the Government on all matters associated with the development of small scale industries. The SSIB's main task is to facilitate coordination and linkage between various agencies/departments engaged in the development of small scale industry.

7. The major function of NISC is to provide machinery to industry on hire purchase basis. It also performs the following functions : Procurement of indigenous and imported raw materials, , supply and distribution, development of export-worthiness of small-scale units and encouraging export of small scale industries products, giving equal priority to the enlistment of competent units and the facilitation of their participate in Government Stores Purchase Programmes, providing training in several technical trades, motivating Small Scale Units on technological upgradation through Software Technology Parks and Technology Transfer Centres, mentoring small scale units and providing advisory services, setting up small-scale industries in other developing countries on turnkey basis and other areas of services and international co-operation.

11.6 SUMMARY

- Economic development of any nation depends upon the development of industries. Small Scale Industries use indigenous technology and provide huge employment opportunities, hence development of small scale industries helps a nation to fulfill the needs of society as well as solve the problem of unemployment.
- An industry needs support from the Government and other agencies to perform its operations. Entrepreneurial development of any nation depends upon the role played by the government and the government promoted support agencies and their schemes.
- Support agencies are essential and are helping entrepreneurs in selection of industry, location of plant, procurement of raw material, determining the size of manpower requirement (skilled, semi-skilled and un-skilled), generation and management of working capital, marketability of goods and services, knowledge of sales tax and central tax, knowledge of bookkeeping and accountancy, transportation and warehousing facilities, and licensing, and government permissions.
- Small scale enterprises not only need financial assistance but also need support and guidance from government agencies in order to bring their ideas into reality and to run the enterprise profitably. In this aspect of entrepreneurial need the Government of India as well as state governments have launched various support agencies such as DIC, SIDBI, SIDCO, SSIB, NSIC, and SISI.
- Central as well as state level support agencies are emerging as very effective services to entrepreneurial development in India. The support agencies are implementing various programmes and facilitating services such as managing industrial estates, providing single window services to clear all government licenses and permissions to launch an industry, procurement and allotment of scare raw material, hire purchase of machinery, subsides on power, water, tax exceptions and incentives by various schemes.

NOTES

11.7 KEY KEY WORDS

- **Support agency:** An organization working under the central or state government to facilitate various services that are needed for entrepreneurial promotion and development
- **Industrial survey:** A survey undertaken by the government to understand the level of development of industry
- **Industrial estate:** A common place provided by state government to make allotments of location for various industries

11.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the main objectives of small scale industry promotion?
2. What is the need of service agencies?
3. What is the structure of DIC?
4. Write a note on incentives and subsidies to enterprises.
5. Briefly discuss the functions of National Alliance of Young Entrepreneurs.

Long Answer Questions

1. 'The awareness and planned efforts of the Central as well as State Governments and the promotional agencies have made a breakthrough in entrepreneurial development'. Discuss.
2. What are the functions of District Industries Centres?
3. Explain the role of Small Industries Development Organization (SIDO) in promoting SSIs.
4. Explain the role of SIDCO in providing consultancy services to small entrepreneurs.
5. 'Institutional support acts as limbs to SSIs'. Do you agree? Discuss.
6. Describe the major schemes of National Small Industries Corporation.
7. Explain the role of TCOs in providing various services to small entrepreneurs.
8. Explain the functions of SISI.
9. Explain the services of ITCOT.
10. Explain the role of government policies and various schemes in developing women and rural entrepreneurs.

11.9 FURTHER READINGS

NOTES

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Endnotes

[1] President, Small and Medium Enterprises (SME) Chamber of India, '2 Lakh Small Medium Units may turn sick on slowdown' *Business Line*, dated: 24 December 2008 p. 5.

[2] Source: http://www.itcot.com/index.asp

[3] Source: http://www.lubindia.org

BLOCK - IV
ENTREPRENEURIAL CULTURE

NOTES

UNIT 12 HARVESTING REWARDS

Structure

12.0 INTRODUCTION

What is the difference between a promoter and an entrepreneur? There is no specific answer to this question, but it will not be inappropriate to say that a promoter is interested in running a business almost on perpetuity after the business is established. However, that is not a prudent strategy for an entrepreneur. An entrepreneur looks for continuous innovations, that may be in product or services, or processes or anything else. In most cases, an entrepreneur would like to maximize monetary benefits and walk away with fortune and get set with new innovation.

In this unit, you will study about the different exit strategies for an entrepreneur, the issue of bankruptcy in case the start-up is not a success and the succession and harvesting strategy as devised by an entrepreneur.

12.1 OBJECTIVES

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

- Describe the exit strategies for entrepreneurs
- Explain how to maximize benefits from an exit
- Define bankruptcy as a desirable option and get to know it at awareness level
- Assess the importance of succession planning in a family business

12.2 EXIT STRATEGIES FOR ENTREPRENEURS

Entrepreneurs need to have an exit strategy. Two main reasons can be cited here– exit at the right time gives more than expected returns and once a business gets going, an entrepreneur may not remain excited about it and may like to try hands on newer ideas and may want to nurture them. A ready exit strategy is, therefore, important for an entrepreneur.

What is Sold in Exit?

One must have a clear idea about what is being sold when a business is sold. This knowledge would help in terms of strategizing for maximizing the benefits from exit. Some important things that are sold when a business is sold would include the following:

- Your client base
- Intellectual property created by the firm
- Brand name
- Unique product and processes
- Team of people that an entrepreneur has put together
- The bricks and mortars of business

How to Maximize Benefits from an Exit?

Exiting a business is easy, but exiting with the maximum benefits would require care and strategy. Some points that an entrepreneur may like to take into consideration when planning for an exit are listed here. They are self-explanatory, therefore, explanation is avoided.

- Think about the various ways of exit and weigh the pros and cons of each one of them.
- Set clear goals for exit and weigh how realistic they are. You need to have a clear understanding about the inherent or intrinsic value of what you are selling.
- Be willing to negotiate the terms of payment and mode of payment. Negotiate your involvement, either as a consultant or as senior executive, in the affairs of sold business; of course for a payment.
- Consider selling to your own employees, if that is more profitable after factoring the tax implications.
- Use services of expert intermediaries, like merchant bankers, to get to more potential buyers and get favourable terms.

Forms of Exit

There are many ways an entrepreneur may exit profitably from the venture established and nurtured by him/her. Some of the important ways are listed and described as under:

(i) Going public

Going public means a privately-owned company would go public by the way of offering its shares to the public. The first public offering by a privately-held company is called as Initial Public Offering (IPO).

There are two situations in which a privately-held firm would go public, namely:

1. If a venture capitalist wants to exit from a start-up at market determined value of the firm.
2. If the start-up wants to access larger market for its appetite for growth and liquidity.

Theoretically, one can say that the present value of the future cash flow of a firm discounted at the cost of capital is the value of the firm and a venture capitalist can take its share in the value of the firm and exit. However, determining future cash flow and also calculating appropriate cost of capital both are very difficult and subjective in nature for a firm that is private. Therefore, often a venture capitalist would prefer the entrepreneur to take the unit public, so that market can do the valuation and venture capitalist can get the fair price.

The entrepreneur also might like to go public and enjoy many benefits that may ensue from it. There are many advantages and disadvantages of 'Going Public' like valuation of firm can be done constantly, market trading of shares among others. The disadvantages are an entrepreneur's loss of control as shareholders are involved and legal restrictions among others.

Thus, going public comes with a mixed bag of advantages and disadvantages. It depends on the entrepreneur to weigh the pros and cons of going public, in the light of situation and real assessment about what actually will turn out to be the advantages and what not.

(ii) Seeking merger and acquisition

A start-up can maximize its value and also its reach to the beneficiaries by seeking merger and acquisition. Merger is a process in which an acquiring firm will merge the acquired firm in it and the acquired firm will lose its entity, though brand may be retained by the acquiring firm. Thus, the acquiring firm buys out the acquired firm completely and the acquired firm would cease to exist.

In acquisition, the acquiring firm would retain the separate entity of the acquired firm, and buy the controlling interest in the acquired firm. Acquisition is possible through market operation also, in which the acquiring firm will buy shares from the market, as per the law, and once controlling interest is bought, would take over the management of the acquired firm. A firm that has gone public stands this possibility. If acquisition is done through market operation, the entrepreneur is likely to be marginalized.

(iii) Selling to private equity fund

There are several private-equity (PE) firms with monetary strength and risk appetite, who are willing to buy potentially profitable ventures, whether in a corporate form or otherwise. PE fund is a good source to access immediate liquidity. If the venture is not registered as a company then pricing would become a contagious issue and often the entrepreneur would get sub-optimal returns. A corporate firm listed on stock market can also seek selling to a private equity fund. In a PE fund arrangement it is possible to negotiate terms wherein the entrepreneur can retain some interest.

(iv) Giving management contract

One more profitable option that the entrepreneur may have for exiting the business is arranging a management contract. This is an arrangement wherein ownership of the enterprise remains with the entrepreneur, but management of the business is handed over to someone else. The entrepreneur would charge a fixed annual amount from a management group. It is also possible to give a management contract for a fixed fee that an entrepreneur would pay the professional management team and an entrepreneur will enjoy the profit.

(v) Liquidating

There may be sometimes when selling business or taking it public may not be possible because of some setbacks in the business. In that case one can liquidate the business. Liquidation of business is very similar to selling a business, except that liquidation takes place when the business cannot be run profitably by the entrepreneur. In liquidation, the business is sold as-it is. Sometimes, the buyer will buy only the assets but not the liabilities; whereas sometimes liabilities are also bought along with assets. Liquidation may also emerge as an option even as a process of bankruptcy, if the business cannot be revived by the entrepreneur.

(vi) Harvesting assets

Harvesting would typically involve selling business to a third party or to selected management team members or to employees through employee stock option plan. If there is no buyer in the liquidation process then one has to harvest the business. Sometimes, harvesting may give more value than liquidation. Harvesting involves selling parts of a business one by one and separately rather than selling it as a business. For example, selling machines, building and open land, among others would mean harvesting in which the business is dismantled and buyers of those assets may put the assets in different uses. Thus, in case of liquidation an entrepreneur pride may hurt less than in harvesting, but sometimes harvesting is the only remaining option or it may give better returns than liquidation.

NOTES

(vii) Filing bankruptcy

Filing bankruptcy may appear to be the admission of failure, but a risk taker need to be open about it, if things do not shape up as expected. When a start-up is facing initial liquidity trouble, the entrepreneur can discuss the matter with various stakeholders and solicit some concessions and support for the firm. If the stakeholders do not come forward so easily then filing legal bankruptcy is a good option because it would immediately give immunity from application of some laws that would otherwise enable the stakeholders to take legal action against the business for their interest.

(viii) Arranging succession

Exit is possible for an entrepreneur through succession arrangement. If no other form of exit is arranged by an entrepreneur then sooner or later exit through succession becomes necessary. Often, if succession planning is not done well, the inheritance issue would do damage to the reputation and value of the business. Succession can be arranged within the family or sometimes an outsider may also be considered to succeed the entrepreneur as the chief executive officer of the business. The protection of interest of the beneficiary acquires the utmost importance when outsider is the successor.

Check Your Progress

1. What does going public mean?
2. What do you mean by harvesting?

12.3 BANKRUPTCY

Bankruptcy or insolvency means a legal declaration of an inability to pay up all creditors, whether by an individual or organization. The legal meaning of the terms bankruptcy, liquidation, winding-up and dissolution are challenged in the Indian legal system, as there is no specific bankruptcy law, especially for organizations. However, the Companies Act, 2013 and the Limited Liability Partnership Act, 2008 have provision for winding-up and dissolution.

Forms or Types of Bankruptcy

The bankruptcy is currently governed under two heads; personal insolvency that deals with individuals, including sole-proprietary firms and partnership firms. Personal insolvency is governed by the Provincial Insolvency Act, 1920 and the

Presidency Towns Insolvency Act, 1908 and corporate insolvency under the Companies Act, 1956. Thus, there are two types of bankruptcy, namely,

- Involuntary bankruptcy
- Voluntary bankruptcy

Alternatively, bankruptcy can be divided into:

- Personal insolvency, and
- Corporate bankruptcy

(i) Involuntary bankruptcy

As the term indicates involuntary bankruptcy is forced upon the company by the action of its creditor or creditors through a court intervention.

(ii) Voluntary bankruptcy

Majority of bankruptcy petitions are initiated by the debtor, which is called voluntary bankruptcy. In voluntary bankruptcy a petition is not filed by the insolvent individual or organization against anybody, but it is just a petition to allow restructuring of business debt or allow winding up if debtors do not agree to any restructuring proposal.

(iii) Personal insolvency

The first Indian Act for facilitating personal insolvency was the Presidency Towns Insolvency Act, 1908, which was applicable to only the people residing in three large cities. Later on the Provincial Insolvency Act was passed in 1920 which covered the rest of India. When a person files bankruptcy under these acts, the court sends notices to all creditors and only after creditors respond to the court notice the insolvency proceeding begins. If the court decides to declare the applicant insolvent, the assets of the applicants are seized and auctioned to pay up the creditors.

However, certain laws allow the person to protect some of the assets. For example:

- *Married Women's Property Act, 1874:* If a person has taken an insurance policy in the benefit of his wife and children the policy amount is protected from being attached for insolvency purpose. Provident fund amount cannot be attached in the insolvency proceedings, as per Section 3 of the Provident Fund Act, 1925.

(iv) Corporate bankruptcy

The following laws are applicable for corporate bankruptcy:

- The Companies Act, 2013
- Sick Industrial Companies (Special Provisions) Act (SICA), 1985; (applicable to industries listed in Schedule 1 only),

- Industrial Development and Regulation Act (IDRA), 1951, and
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

NOTES

Winding up

The Indian Companies Act, 1956 is applicable where the expected consequence is winding up of the business, and not restructuring of business. Section 433 (e) of the Companies Act, 1956 is about the winding up of a company that is 'unable to pay its debt'. Inability to pay the debt can be adjudged so when:

(a) a company's entire capital is wiped off due to heavy accumulated losses

(b) no accounts are prepared and filed, and

(c) no business is done for one tear.

Section 434 of the Companies Act prescribes 'inability to pay debts'. In such cases, the Registrar of Company would prepare a case for inability to pay debts and move a court for appropriate decree in the matter.

Chapter XX and sections 270 to 365 of Companies Act, 2013 deal with the provisions of winding up.

Restructuring

Sick Industrial Companies (Special Provision) Act (SICA), 1951: In 1951 India enacted a law Sick Industrial Companies (Special Provisions) Act (SICA), which is applicable to industries listed in Schedule 1 only. As the name of the Act suggest, not all businesses but only industries, that to listed ones only, were provided chance to prevent sickness so that the social costs (like loss of employment, loss of production, loss of capital, etc.) can be avoided.

Industrial Development and Regulation Act (IDRA), 1951: In the year 1951 the Industrial Development and Regulation Act (IDRA) was enacted for the development and regulation of selected industries. This Act also provides regulations for preventing sickness among these industries. Both Acts aim at preventing industrial sickness, and therefore, the Acts authorize Central Government to issue directives to the industrial undertaking after investigation is done with the permission of High Court.

Board of Industrial and Financial Reconstruction (BIFR): Under this Act, Board of Industrial and Financial Reconstruction (BIFR) is established. BIFR is a quasi-judiciary body and has the powers for taking all remedial steps for "revival of a viable sick company and for liquidation of non-viable sick company". However, if a non-viable company has to be wound up the BIFR has to record and forward the opinion or suggestion to the concerned High Court.

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002

Financial sector reforms, especially banking sector reforms warranted to reduce the non-performing assets of banks. For achieving this goal SARFAESI Act, 2002 was enacted, which enables banks and financial institutions (FIs) to take possession of securities of defaulting borrowers and sell them. This has helped banks and FIs to manage their problems of non-performing assets, liquidity and asset-liability mismatch by taking possession of securities and selling them. The possession can be taken by just giving notice and without going through lengthy court procedure.

Debt-Recovery Tribunal (DRT): While the simplified procedure gives lender an edge, the same provisions may be misused against the genuine borrowers. Using the case laws of high courts and Supreme Court, the DRT has come out with a very significant and effective player in charting its effectiveness such that it has almost become a model for other countries.

Asset Reconstruction Companies (ARCs): Under the SARFAESI Act, Asset Reconstruction Companies (ARCs) are established. ARCs specialize in acquiring non-liquid assets from the defaulting borrower and recover banks and FI's over dues.

Need a new bankruptcy code

India needs a strong bankruptcy code at the earliest. All the board members must agree on the state of business before the company is referred to BIFR; and the current laws do not provide specific instructions for liquidation of assets. Laws also leave room for the misuse of protection against recovery proceedings.

Surviving Bankruptcy

Not all bankruptcy petitions end up with winding up.

(i) Monitoring and early signals

There are always several early signals of onset of sickness that a good monitoring system would catch. Some of the early signals can be listed as under:

- Difficulty in matching cash inflow and outflow, resulting in delay in payment to creditors.
- Struggle to make faster collections from customers, even by offering good discount.
- Bank asking for more securities.
- Key employees leaving the organization.
- Supply of material required for smooth operations is disrupted.
- Customers' complaints are increasing for services and quality.

(ii) Turning-around

It is in the interest of all stakeholders including the company, creditors, workers, suppliers, contractors and government, if the company survives. A successful turnaround plan is carefully prepared by experts. A good turnaround plan will set few milestones and target dates to achieve them. For example:

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Milestones	Target Date
Generate positive operating cash flow	1 to 2 years
Generate positive accounting profits	2 to 3 years
Accumulate sufficient reserves	3 to 4 years
Grow normally	After 4 years

The target dates will depend on industry stability. Core industry with good degree of stability of demand and technology may take longer to attain the milestone, whereas, a firm in volatile environment and uncertain demand would have to attain the milestone earlier.

After the milestones and target dates are determined, one has to prepare a plan for revival. Some ways for improving immediate liquidity that may be considered in a turnaround plan could be:

Venture capitalist may bring in more money either as equity or loan, an entrepreneur may bring in more equity and provide interest free loan to the business, lenders may be asked to capitalize accumulated interest as well interest (at low rate) of the next few years, etc.

The turnaround plan that includes sacrifices and business plans over the phases is then analysed for checking for viability. If the present value of future incremental cash flow is more than the present value of sacrifices made by all the stakeholders, then it is called a viable turnaround plan and it can be accepted. However, a business is considered terminally ill and non-viable if no turnaround plan can create a positive value after deducting the sacrifices from the present value of future incremental cash flows. In that case it is advisable to explore other options as exit strategy.

Check Your Progress

3. What laws are applicable for corporate bankruptcy?
4. What was the first Indian Act for facilitating personal insolvency?

12.4 SUCCESSION AND HARVESTING STRATEGY

Many start-ups are family owned. Sooner or later an entrepreneur has to think and plan about succession, especially if he/she has not exited from the venture. There are two options for a succession plan, namely:

- Transfer to family members
- Transfer to other than family members

Transfer to Family Members

Inheritance of property other than a running business may be relatively easy, but transfer of an enterprise to family members is often very difficult and has to be done in time and with due care. It also has tax implications. Induction of family members who have the right frame of mind for running and nurturing business, possession of entrepreneurial skills, and handing over the responsibility in gradual fashion would allow ample time for training and commanding respect from all employees, and especially from key employees.

Transfer to Other than Family Members

There may be a possibility against transferring business to a family member. There may not be a natural heir of the entrepreneur, a natural heir may not be competent to run the business, natural heir may not be interested in running the business, or even the entrepreneur may like to exclude family members to avoid any family feud that may possibly occur due to transition and adversely affect the business. Thus, there may be several reasons why sometimes transfer of business to a non-family member could be desirable.

There are three options for transferring business to other than family members: (i) Transfer to employees, (ii) hire a professional manager, or (iii) sell outright.

In the first two cases, the entrepreneur may retain some control and/or financial stake in the enterprise. However, these two options can be also considered to transition into a sale at some future date. The other option is complete employee buy-out of the firm, in which the original entrepreneur would cease to be the whole or part-owner of the enterprise.

An entrepreneur is mostly interested in ensuring that the enterprise started by him not only survives but flourishes even after he has handed over the charge and ownership. This is purely a psychological requirement and therefore, the entrepreneur may not look for the best price while exiting from business.

Harvesting Strategy

Harvesting of business though becomes necessary when in the process of bankruptcy it is realised that the business is not viable. At this time business is not harvested or sold voluntarily but through court intervention. If there is no buyer of the business-as-is then assets are sold one by one and the proceeds are used for repaying the dues in the order of priority as laid down by the law. This is called salvaging. An entrepreneur may consider harvesting as exit strategy and consider either direct sale, management buy-out or employee stock option plan.

(i) Direct sale

Mergers and acquisition is often easy when a firm is publicly traded firm. If the firm is in a partnership form, one or more of the co-owners may consider selling his/

their interest to the remaining partners. In case of a sole proprietorship and partnership forms the valuation of business is difficult. Therefore, businesses are sold based on some thumb rules like, x-times last three years' average sales revenue or y-times the last three years' average net profits, among others. This x-times or y-times are location and industry specific based on the common understanding of business scope in that location.

Payment terms are important to negotiate and not just the payment amount. Though the entrepreneur may like to be relieved instantly from all obligations, it may not be desirable nor could be possible in the interest of the business, buyer and employees of the business. It may, in fact help if services of broker is used for selling the business.

(ii) Management buy-out

An entrepreneur may like to reward some key and important management team members by inviting them to acquire and own the business rather than selling it to any outsider. In this case both the sides are operating from the full knowledge perspective and therefore, easy deal is possible with full trust and confidence. Moral obligations of both the sides will continue for quite some time. The management buy-out has one more important advantage; the relationship with employees, lenders, customers and suppliers remains almost unchanged and therefore, continuing business effectiveness is easy.

The offer for management buy-out may be by invitation. Before the invitation is extended an assessment of fair value becomes essential. An instalment payment option linked with cash flow potential of business can remain central while exploring other options for raising money for the new management team. Tax implications cannot be ignored in determining payment terms.

(iii) Employee stock option plan (ESOP)

Stock option plans are designed to retain employees for longer period. It is also called sweat equity, because it is made available if employees 'sweat' for some period. ESOP is a variation of making employees part-owners of business, so that they work harder to create firm's value. As the term indicates, ESOPs are possible when the shares are traded on the stock market, though ESOPs are designed for unlisted firms also.

Expert services are available in the market for designing and managing employee stock option plan, otherwise managing it on one's own may be difficult and controversial. Price of stock option, determining how many stock should be given in the option, timing of making it available, vesting period of stock option, option to buy more than entitlement, and several other highly complex issues are involved in designing the stock option plans. ESOPs would work if the firm is actually able to create value that reflects in increasing share price, otherwise it will not work as an incentive. Some employees may view it as a deferred payment of salary, with risk built into it.

Using ESOP route for harvesting is a more challenging issue, as harvesting would mean offloading almost all shares of promoters or entrepreneur in favour of employees. It would amount to employee takeover of the firm, which would create a very unique situation where employees are the shareholders who elect board of directors, under whom they work.

Check Your Progress

5. What are the two options for a succession plan?
6. What are the three options for transferring business to other than family members?

12.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Going public means a privately-owned company would go public by the way of offering its shares to the public. The first public offering by a privately-held company is called as Initial Public Offering (IPO).
2. Harvesting would typically involve selling business to a third party or to selected management team members or to employees through employee stock option plan.
3. The following laws are applicable for corporate bankruptcy:
   - The Companies Act, 2013
   - Sick Industrial Companies (Special Provisions) Act (SICA), 1985; (applicable to industries listed in Schedule 1 only),
   - Industrial Development and Regulation Act (IDRA), 1951, and
   - Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
4. The first Indian Act for facilitating personal insolvency was the Presidency Towns Insolvency Act, 1908, which was applicable to only the people residing in three large cities.
5. There are two options for a succession plan, namely:
   - Transfer to family members
   - Transfer to other than family members
6. There are three options for transferring business to other than family members: (i) Transfer to employees, (ii) hire a professional manager, or (iii) sell outright.

12.6 SUMMARY

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- If a start-up is established for making money, then the best way of making money is through harvesting the business at opportune time. In some cases, a business may even fall sick and may have to undergo a winding-up process. All these situations involve change in ownership and management of business.
- It is important for an entrepreneur to know in the beginning what are being sold when an exit strategy is implemented. Selling a business means selling client base, selling Intellectual Property created by the firm, selling brand name, selling unique product and processes, selling team of people that entrepreneur has put together and selling the bricks and mortars of business. Therefore, one should aim at maximizing benefits from selling a business.
- Advance preparation for attaining good turnover, profits and growth are key determinants of selling advantage. Determining fair price of business is always a difficult task, especially for a firm whose shares are not actively traded on the stock market.
- Pricing will become an issue more so in case of a non-listed firm. Even in case of a listed firm pricing of merger is more of a psychological war between the parties. In both the options, in addition to earning a good price for the venture, the entrepreneur may retain key position for himself in the sold organization.
- Inviting a private equity firm for purchase of some stake in the business is one more option. Exercising this option becomes necessary, especially when the firm is in liquidity crisis and there is an immediate need for influx of liquidity before the implicit value of the firm is created. After getting much needed funds, when the business is turnaround, the entrepreneur may sell his stake to the private equity firm and walk out with fair value.
- Two separate sets of insolvency laws are applicable to personal insolvency. For corporate bankruptcy also there are multiple laws, as the Companies Act, 2013 addresses only winding-up issue. Restructuring may involve sacrifices by different stakeholders, if the firm can be revived. However, if there is no plan that can revive the business the BIFR would refer the case to the court asking for winding-up of the company.

12.7 KEY WORDS

- **Bankruptcy:** Bankruptcy is a state of an individual or a firm in which the financial position does not allow him/it to honour the dues from him/it. It is somewhat different than insolvency, though the situation is almost the same that in bankruptcy there is a chance of survival of a firm.

- **ESOP:** Employee Stock Option Plan is a plan in which on fulfilment of certain conditions employees are entitled to get stock options by exercising which on completion of vesting period the employee becomes co-owner of a business, and by selling the same in market one can get profit if share prices have increased.
- **Insolvency:** Insolvency is a state of an individual or a firm in which he or it is not in a position to honour the obligations. The value of assets is less than the liabilities.
- **Management buyout:** Management buyout is a method of harvesting a business in which the entrepreneur would offer the business for sale to select key management team members.
- **Succession plan:** Succession plan is a plan for handing over the ownership and management of the business either to family members or to outsiders.
- **Turnaround:** Turnaround is a process of implementing a strategy for a sick industrial unit to come out of the sickness and getting back to a normal situation.

12.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the differences between liquidation and harvesting of a business?
2. How can one maximize the benefits from exit?
3. List the laws that govern (i) personal insolvency and (ii) corporate insolvency in India. What are the disadvantages of the current corporate bankruptcy laws in India?

Long Answer Questions

1. Discuss the advantages and disadvantages of going public as an exit strategy.
2. Explain the terms 'giving management contract' and benefits of it to an entrepreneur who wants profitable exit from business.
3. What is private equity fund? How can they help in profitable exit of an entrepreneur?

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UNIT 13 PROGRAMMES FOR DEVELOPING ENTREPRENEURSHIP

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Structure

13.0 INTRODUCTION

Entrepreneurship Development Programme (EDP) is a programme which helps in developing the entrepreneurial abilities. The skills that are required to run a business successfully, is developed among the people through this programme.

Importance of entrepreneurship development is to enable the individuals grow into a dynamic entrepreneur who is able to initiate and sustain the economic growth of the country. Their ventures not only initiates wealth but also becomes inspiration for others.

13.1 OBJECTIVES

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

- Describe the various entrepreneurship development programmes
- Discuss the meaning of seed capital assistance
- Analyse the backward area development schemes
- Discuss sales tax concessions and energy concessions

13.2 ENTREPRENEURSHIP DEVELOPMENT PROGRAMMES AND RECENT TRENDS

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Entrepreneurship environment comprises the various facets within which enterprises (big, medium, small and others) have to operate. However, entrepreneurship is influenced by an environment created by political, social, economic, national, legal forces, etc. Entrepreneurship, therefore, will flourish only under the right atmosphere which is conducive to the social, political and economic issues. Entrepreneurial environment provides high awareness on whether there is existing potential, whether enough source of capital is available, and also whether there are sufficient number of individuals and institutions which provide adequate help and advice for the establishment and growth of industrial enterprises. Though the entrepreneurial environment is a key element of entrepreneurship development, we cannot ignore the knowledge and skills of entrepreneur in optimum utilization of the conditions conducive for entrepreneurship. Even though entrepreneurship environment is supportive, failure of entrepreneur in strategic and operational understanding due to the lack of training and guidance is a loss to him as well as to the nation. Here the vacuum was identified to realize the importance of an entrepreneurship development programme.

The fact that 'entrepreneurs are made but not born' is the key factor for the encouragement of EDPs. After the second industrial policy resolution in 1956 and the subsequent industrial policy resolutions, the government provided a big hand of assistance and support to the development of small and medium-scale industries in India. The favourable entrepreneurship environment is not just enough for good number of entrepreneurial success, but EDP support is also essential.

In India, the first successful EDP was conducted and organized by NIESBUD for entrepreneurship development.

Kakinada Experiment

Kakinada is an industrial town in Andhra Pradesh. The Kakinada experiment started in January 1964. The main objective of the experiment was to break the barrier of limited aspirations by inducing achievement motivation. A total of 52 persons were selected from the business and industrial community of the town. They were given an orientation programme at Small Industry Extension Training Institute (SEIT), Hyderabad. The participants were grouped into three batches. They were put under training for three months.

The training programme was designed in such a way that it could help the trainees to improve imagination and enable them to give boost to their motivation. Accordingly, the programme included the following items in its syllabi:

- The individuals strived to attain concrete and regular feedback.
- The participants sought models of achievement to emulate.

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- The participants thought of success and accordingly set plans and goals.
- The participants were encouraged to think and talk to each other in a positive manner.

The impact of this training programme on the participants' behaviour was observed after a period of two years. The observations were encouraging. It was found that those who attended the programme performed better than those who did not. The participants' need for achievement was assessed by using TAT. In this TAT, ambition-related pictures were displayed to the trainees and then they were asked to interpret pictures and what happened in the picture. Thereafter, all the themes related to achievement were counted and, thus, the final score represented one's need for achievement. McClelland conducted that the training programme positively influenced the entrepreneurial behaviour of the participants. As regarding caste, the traditional beliefs and imitation of Western culture, they did not determine one's behaviour as an entrepreneur.

Hence the Kakinada experiment made us realize that entrepreneurship must be developed from a very young age. Accordingly, efforts have been made to develop a school curriculum that would result in a high need for achievement among the students. For this purpose, the success stories drawn from history and legends of the indigenous culture are introduced in course curriculum to induce in young minds the 'need for achievement' and strong desire to do something good/great when they grow up. This is because the younger minds are more susceptible to change.

Stages of Performance

The Kakinada experiment and other various motivation campaigns or programmes taken up by the Small Industries Service Institute and SIET in the 1960s tried to fill the existing information gaps relevant for small entrepreneurs. The entrepreneurs required a lot of information and technological know-how for setting up businesses and in that context, the contribution of these programmes was essentially in the area of propagating knowledge on financial, technical and managerial aspects. In this context, the EDPs were in the nature of supportive programmes for the existing and new potential entrepreneurs. It was experienced by the government that mere creation of all external facilities is not a sufficient condition for the promotion of entrepreneurship. The realization on this issues brought an amicable solution by giving equal importance to the qualities of the individual who responds to the external opportunities such as availability of funds, financial incentives, etc.

The stages of performance are broadly classified as follows:

- **Support:** This is the primary stage of the entrepreneurial cycle. To assess the performance of EDP at this stage, it has to be observed whether the programme adequately provided the knowledge in the areas of:
  - (a) registration of unit
  - (b) financial institutions

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(c) selecting and obtaining machinery

(d) getting licences

(e) government schemes, incentives and subsidiaries

(f) marketing of products

- **Sustaining:** This is the second stage of entrepreneurial cycle. The performance of EDP according to this stage demands on the following observations in strengthening the knowledge in the areas of:

  (a) modernization, (b) diversification/expansion/substitute production and (c) additional sources of financing for full-capacity utilization.

- **Simulatory:** In the third stage of the entrepreneurial cycle, the performance of EDP focusses on (a) entrepreneurial education, (b) motivational training to new entrepreneurs, (c) guidance in selecting products and preparing project report and (d) entrepreneurial counselling and promotion by trained external agencies.

It is very essential and important that the government and the financial institutions are on forefront in entrepreneurial development. It is said that several training programmes organized by these institutions work at training for people for self-employment to acquire gainful employment. Hence, the basic purpose of developing entrepreneurial talent among the youth is defeated. This calls for a critical evaluation of EDPs and of personnel with confidence and commitment to undertake the task of planning, designing and implementing programmes in this area. It is obviously needed to realize that entrepreneurial programmes must be in tune with Indian economic environment and be made available in regional languages. At this time, genuine, and not imitative, entrepreneurs must be developed to accelerate the process of industrialization. This is the time also for stimulating innovation and the entrepreneurial spirit to support the development of new ideas through new and grown-up enterprises.

Evaluation of EDP

Evaluation of EDP can be judged on the basis of extent of success achieved in the realization of objectives established under EDP. According to Dr Sharma, entrepreneurial performance is a function of the following factors.

- *Socio-cultural background of the entrepreneur (SB):* This implies the environment in which the entrepreneur was born and brought up. It conditions the values and attitudes of the entrepreneur.
- *Motivational force (MF):* It implies the motives which prompts a person to undertake entrepreneurship, e.g., wealth, status, self-employment, etc.
- *Knowledge and ability of the entrepreneur (KA):* It refers to the education, training and experience of the entrepreneur.
- *Financial strength (FS):* It means the funds which an entrepreneur can mobilize from internal and external sources.

- *Environmental variables (EV):* These consist of government policies, market conditions, availability of technology and labour situation. Symbolically entrepreneurial performance (EP) can be represented in the following way:

$$EP = f(SB, MF, KA, FS, EV)$$

Various studies have been undertaken by different organizations to find out how many participants in different EDPs have actually started their own enterprise after completing their training under EDPs. Entrepreneurship Development Institute of India, Ahmedabad, had recently undertaken a nationwide evaluation study on the effectiveness of EDPs. The major findings of this study are:

- One out of four trainees actually started his/her enterprise after completing EDPs.
- The final start-up rate is higher around 32 per cent.
- About 10 per cent trainees are found blocked due to various reasons at various stages in the process of setting up their enterprises. If proper assistance is not provided, they may add to the category of 29 percent trainees who have already dropped the idea of setting up their own enterprises.
- About 17 per cent have given up the idea of starting their ventures as they are engaged in other activities.

The following main criteria can be employed to comment on the performance of entrepreneurs.

- *Financial results:* Judgment about the financial health of the enterprise can be made on the basis of various yardsticks like return on capital employed, net profit over sales, etc.
- *Gestation period:* It represents the time gap between the registration and commencement of commercial production. Gestation period of two to three years is regarded as satisfactory by the financial institutions. Projects can be delayed due to various reasons like delay in governmental approvals, assistance from financial institutions, manpower availability problem and problems with collaborators.
- *Capacity utilization:* It depends upon the demand for finished products and availability of various factors of production like funds, raw material, power labour, etc. Break-even occurs for majority of entrepreneurs at 60 per cent of installed capacity. Approximately 50 per cent of entrepreneurs were operating at 80 per cent of the installed capacity.
- *Expansion and diversification:* Expansion refers to the increased production of the same product whereas diversification implies the production of new type of products. Depending upon the demand and availability of resources, firms can opt for expansion or diversification.

- *Value addition:* It refers to the gross value of output minus value of raw materials and other inputs used in the production. The more is the value addition, the more efficient the entrepreneur.
- *Other factors:* Various other factors can be used to examine entrepreneurial effectiveness. Employment generation, rural development, sales turnover, export promotion and import substitution can be some of these factors.

13.2.1 Seed Capital Assistance

Seed capital is the initial capital used to start a business. This capital can come from founders, friends or families. It has been observed that many people mistake seed capital to be the fund needed to simply cover your initial office expenses and avoid the use of personal cash. Seed funding has a lot more to it than what meets the eye. It is required for the early expansive market research, product development, and other initial stage operations.

Seed funding allows you to explore the business idea and transform it into a viable product or service that further attracts venture capitalists. It is the ground work you do for your Series-A funding. A business founder must have an exact map of how to use seed capital in the best way to ensure smooth transition to the advanced stage of the business.

13.2.2 Capital Assistance/subsidy

The 1991 industrial policy announced 30 percent State Capital Investment Subsidy on cost of fixed investment. The 1997 policy retained this subsidy. The 2003 industrial policy raised the ceiling of subsidy from Rs 10 lakh to ₹ 20 lakh and for export-oriented unit (EOU) ₹25 lakh. There was no state investment subsidy in the 2008 industrial policy.

13.2.3 Backward Area Development Schemes

The primary responsibility of industrial development of backward areas rests with the State Governments. The Union Government supplements their efforts through various schemes launched by it with a view to promote industrialization in industrially backward areas of the country.

Department of Industrial Policy & Promotion (DIPP) is implementing the following Schemes with a view to promote industrial development of backward areas of the country:

- **North East Industrial and Investment Promotion Policy (NEIIPP 2007)**: Incentives provided under the Policy are:
  - o Central Capital Investment Subsidy Scheme
  - o Central Interest Subsidy Scheme
  - o Comprehensive Insurance Scheme

o Excise duty exemption on Value Addition basis and

o 100% Income Tax exemption

- **Special Package Scheme for Himachal Pradesh and Uttarakhand:**

  Under this scheme, Capital Investment Subsidy is provided for all new units and to the existing units on substantial expansion @15% of investment of plant & machinery subject to a ceiling of ₹ 50 lakh for MSME units and ₹ 30 lakh for others.

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- **Special Package Scheme for Jammu & Kashmir (J&K)**

  Under this Scheme following financial assistance is provided:

  o Capital Investment subsidy for all new units and to the existing units on substantial expansion- for MSME @ 30% of investment in plant and machinery with a ceiling of ₹ 3 crore for Manufacturing units and ₹1.5 crore for Service Units, whereas for other units it is @ 15% of investment in plant and machinery with a ceiling of ₹ 30 lakh.

  o Interest subsidy @ 3% on the average daily working capital loan for a period of five years from the date of commencement of commercial production.

  o Insurance subsidy for all new units and to the existing units on substantial expansion to the extent of 100% for a period of five years from the date of commencement of commercial production.

- **Freight Subsidy Schemes (FSS), 2013/Transport Subsidy Scheme (TSS), 1971**

  o Transport Subsidy Scheme for the States of Himachal Pradesh, Uttarakhand, J&K, Darjeeling district of West Bengal, Andaman and Nicobar Islands, Lakshadweep Islands and 8 North Eastern States

13.2.4 Sales Tax GST Concession

In order to give budding entrepreneurial ventures a much-needed boost, the government has decided to do away with taxing them for the first three years of their operation. It was declared in the Budget Session of the Parliament that startups will not incur any taxes on profits incurred in their first three years except MAT. MAT stands for 'Minimum Alternate Tax' and is calculated on 'book profit'.

A business is carried either for sale of goods or rendering of services or both. These aspects of a business require the consideration of indirect taxes which currently is followed as the GST regime. GST provides for a single legislation for the regulation of taxes on goods and services. It has provided for the percentage to be charged as tax with respect to various categories of goods and services. IGST provided for the taxation rates and structure when there is exchange of such goods or services or both interstate. Under the GST regime, tax is to be paid by the taxable person who undertakes the supply of goods and/or services. It mandates that the taxable person must be carrying on a business of supplying goods and/or

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services must pay GST when the business crosses the threshold limit of ₹20,00,000. This can be said to be an exemption i.e., only once a business crosses ₹20,00,000, it is liable to pay tax. In order to pay tax under the GST regime, the taxpayer must be registered for the same. Upon registration a unique identification number i.e., GSTIN is allotted for further recognition. GST also provides for certain categories of goods and services which are exempted from being taxed under GST. Input tax credit may also be claimed by the taxpayer but in order to do the same it is necessary to be registered under the GST. The GST legislations have specifically stated the rules that compliance that is to be carried out by the taxable persons.

13.2.5 Energy Concessions

The 1991 industrial policy announced power subsidy based on connected load and for a period of 5 years. The 1997 policy made the power subsidy available to the industrial units in the form of reinvestment of fully paid power bills. The 2003 industrial policy also announced power subsidy on the power tariff paid against the actual units consumed for a period of 5 years. The 2008 policy, makes changes in respect of connected load, rate of subsidy ceiling of subsidy. The 1991 industrial policy proposed to subsidize cost of drawal of HT/LT line under development subsidy of the policy. The 1997 policy provided for drawal of power line under miscellaneous subsidy. The 2003 policy announced 20 per cent of the cost payable to ASEB for drawal of HT/LT power lines up to the factory premises. In the new policy subsidy is raised to 25 percent on drawal of power line. In addition, there was subsidy on generating set 191 including non-conventional energy generating sets in 1991 policy. This incentive was retained in 1997 and 2003 policy. The 2008 industrial policy did not announced any subsidy on generator set.

Check Your Progress

1. Who conducted the first successful EDP in India?
2. What was the main objective of the Kakinada experiment?
3. What incentives are provided by the North East Industrial and Investment Promotion Policy?
4. What does MAT stand for? How is it calculated?

13.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. In India, the first successful EDP was conducted and organized by NIESBUD for entrepreneurship development.
2. The main objective of the experiment was to break the barrier of limited aspirations by inducing achievement motivation. A total of 52 persons were selected from the business and industrial community of the town.

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3. Incentives provided under the Policy are:
   - o Central Capital Investment Subsidy Scheme
   - o Central Interest Subsidy Scheme
   - o Comprehensive Insurance Scheme
   - o Excise duty exemption on Value Addition basis and
   - o 100% Income Tax exemption
4. MAT stands for 'Minimum Alternate Tax' and is calculated on 'book profit'.

13.4 SUMMARY

- Entrepreneurship environment comprises the various facets within which enterprises (big, medium, small and others) have to operate. However, entrepreneurship is influenced by an environment created by political, social, economic, national, legal forces, etc. Entrepreneurship, therefore, will flourish only under the right atmosphere which is conducive to the social, political and economic issues.
- Though the entrepreneurial environment is a key element of entrepreneurship development, we cannot ignore the knowledge and skills of entrepreneur in optimum utilization of the conditions conducive for entrepreneurship.
- Even though entrepreneurship environment is supportive, failure of entrepreneur in strategic and operational understanding due to the lack of training and guidance is a loss to him as well as to the nation.
- The Kakinada experiment started in January 1964. The main objective of the experiment was to break the barrier of limited aspirations by inducing achievement motivation. A total of 52 persons were selected from the business and industrial community of the town. They were given an orientation programme at Small Industry Extension Training Institute (SEIT), Hyderabad. The participants were grouped into three batches. They were put under training for three months.
- The Kakinada experiment and other various motivation campaigns or programmes taken up by the Small Industries Service Institute and SIET in the 1960s tried to fill the existing information gaps relevant for small entrepreneurs.
- Seed capital is the initial capital used to start a business. This capital can come from founders, friends or families. It has been observed that many people mistake seed capital to be the fund needed to simply cover your initial office expenses and avoid the use of personal cash.
- Seed funding has a lot more to it than what meets the eye. It is required for the early expansive market research, product development, and other initial stage operations.

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- The 1991 industrial policy announced 30 percent State Capital Investment Subsidy on cost of fixed investment. The 1997 policy retained this subsidy. The 2003 industrial policy raised the ceiling of subsidy from Rs 10 lakh to ₹ 20 lakh and for export-oriented unit (EOU) Rs25 lakh. There is no state investment subsidy in the 2008 industrial policy.
- The primary responsibility of industrial development of backward areas rests with the State Governments. The Union Government supplements their efforts through various schemes launched by it with a view to promote industrialization in industrially backward areas of the country.
- In order to give budding entrepreneurial ventures a much-needed boost, the government has decided to do away with taxing them for the first three years of their operation. It was declared in the Budget Session of the Parliament that startups will not incur any taxes on profits incurred in their first three years except MAT. MAT stands for 'Minimum Alternate Tax' and is calculated on 'book profit'.

13.5 KEY WORDS

- **Seed capital**: It is the initial funding used to begin creating a business or a new product. Obtaining seed capital is the first of four funding stages required for a startup to become an established business.
- **Small industries service institutes (SISI's)**: These are set-up one in each state to provide consultancy and training to small and prospective entrepreneurs.

13.6 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. How are the stages of performance broadly classified?
2. Differentiate between seed capital assistance and capital assistance.
3. Write a short note on energy concessions.

Long Answer Questions

1. Analyse the process of evaluation of EDP.
2. Discuss the recent trends in entrepreneurship development programmes.
3. Describe the various backward area development schemes.

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UNIT 14 ENTREPRENEURIAL CULTURE

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Structure

14.0 INTRODUCTION

Entrepreneurial culture can be defined as a combination of tangible man-made objects and intangible concepts. It specifies the vision, norms and traits that are helpful in the development of the economy. The entrepreneurial culture is beneficial for the organization is important as it helps in the judicial utilization of limited resources through innovation. The entrepreneurship culture promotes the thriving of entrepreneurs who are considered to be change agents. To ensure the acceptance of entrepreneurship culture, help is required from administrative structures like the government and its initiatives. In this unit, you will learn all about the concept of entrepreneurial culture and its relationship with the society; the meaning, need and scope of Intrepreneurship and the concept of management of change.

14.1 OBJECTIVES

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

- Discuss entrepreneurial culture and society
- Explain the meaning, importance, need and scope of Intrapreneurship
- Describe the concept of management of change

14.2 ENTREPRENEURIAL CULTURE AND SOCIETY

Culture helps differentiate human societies from animal groups. Culture of a group can be described as customs, ideas and attitudes shared by individuals of the group.

These customs, ideas and attitudes are transmitted from one generation to another by means of a learning process and not through biological inheritance. Culture basically consists of two different elements; one is called material culture and other is known as non-material culture. Material culture comprises of materialistic things, like automobile, television and telephone. On the other hand, non-material culture comprises of factors such as language, beliefs, music and values. According to McClelland, 'Culture in its broadest definition, refers to that part of the total repertoire of human action, which is socially, as opposed to genetically, transmitted.'

According to Edward Burnett Taylor, 'Culture of civilization is that complex whole, which includes knowledge, belief, art, morals, law, custom and other capabilities and habits acquired by man as a member of society.'

According to Francis Merill, 'Culture:

- is the characteristically human product of social interaction,
- provides socially acceptable patterns for meeting biological and social needs,
- is cumulative, for it is handed down from generation to generation in a given society,
- is meaningful to human beings because of its symbolic quality,
- is learned by each person in the course of his/her development in a particular society,
- is a basic determinant of personality and,
- depends for its existence upon the continued functioning society but is independent of any individual or group'.

Entrepreneurial culture can be defined as a combination of tangible man-made objects and intangible concepts. Examples of tangible man-made objects include automobiles, clothing, furniture, buildings and tools. On the other hand, laws, morals and knowledge are the examples of intangible concepts.

Entrepreneurial culture specifies vision, norms and traits that are helpful in the development of the economy. On the basis of graphics and human characteristics, entrepreneurial culture can be divided into different types of sub-cultures, which are as follows:

- Business ethics
- Organization's culture
- TQC
- Culture of business

Let's discuss each of these types, in detail.

1. Business Ethics

Business ethics has different meaning for different people, but generally its purpose is to decide what is right or wrong in business. According to Wallace and Pekel, 'attention to business ethics is necessary during times of fundamental change as the moral values that were not taken seriously are strongly questioned at that time'. Business ethics is the method of dealing with those business problems that are unclear in nature. Following are the advantages of business ethics:

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- Business ethics programmes guide leaders in decision-making so that they always take the right decisions.
- Business ethics help to avoid criminal acts 'of omission' and it also helps in lowering the fines. Ethics help in finding the violation of ethical issues and helps in rectifying the violation that is committed by the organization.
- Business ethics help to identify and manage the values associated with quality management, strategic management and diversity management. For managing these values, ethical programmes record the values, develop policies andprocedures and then provide training to the employees about these policies and procedures.
- Business ethics helps in building a strong and positive public image of an organization.
- Business ethics strengthen the organization's culture. Ethical values improve relationships between organizations and customers. It strengthens the organization by ensuring consistency in the standard and quality of its product.
- Business ethics helps in improving the society by establishing government agencies, unions and laws and regulations in the society.

2. Organizational Culture

Every organization has its own culture, which is intangible and provides meaning, directions and the basis of action. According to Schein, 'The deeper level of basic assumptions and beliefs that are: learned responses to the group's problems of survival in its external environment and its problems of internal integration; are shared by members of an organization; that operate unconsciously; and that define in a basic 'taken-for-granted' fashion in an organization's view of itself and its environment. Productive cultural change occurs in an organization if strategists appropriately identify the existing culture and evaluate it against the cultural attributes required to attain the strategic objectives.'

An organizational culture can be used as a filter to interpret and to react to the environment. A complexity theory approach focuses on the constantly changing organizational culture. The changing organizational culture affects the behaviour of the individuals within the organization and thus, destabilizes the organizational structure. An organization culture is said to be good if it supports high performance, quality, involvement, openness, freedom of communication and a mutual trust of the organization.

Organizational culture is an outcome of the interactions between the agents of the organization and the environment. Interactions can be explicit or tacit.

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Changing the organizational culture means to change various interactions. A classical approach to management emphasizes on changing organizational structure instead of focusing on core beliefs ingrained in the culture. Classical approach helps in identifying the existing culture of the organization and modifies the organizational culture as per the needs of the organization.

The culture of an organization is an amalgamation of the values and beliefs of the members of the organization. Every organization has a unique culture that helps in the growth of the organization. Organization culture is affected by many internal and external factors such as market, shareholders, leadership style, technology and suppliers. There are different types of organization cultures, which are as follows:

- **Power culture**: It is based on the dominance of one or small number of individuals who take important decisions for the organizations. This culture is generally found in a small business or part of larger business.
- **Role culture**: It is found in large hierarchical organizations in which the roles or jobs of an individual are clearly defined.
- **Task culture**: This culture exists when teams or groups are formed in order to complete the task.
- **Person culture:** It is the most individualistic form of culture that exists when individuals are free to express their views. A person culture exists only in a loose form of organization.

3. Total Quality Culture (TQC)

TQC can be defined as a sum of norms, beliefs and values that control the behaviour of individuals and groups within the organization. TQC provides a method for integrating the number of efforts that occur between organization and employees, task and employees, and employees and employees. The main objective behind integrating all these efforts is to ensure total quality for the product. TQC is very useful in improving quality of work life, employee satisfaction and customer satisfaction.

4. Culture of Business

Culture of a business unit can be described as a combination of beliefs, norms and values that control the behaviour of the individuals and groups within a given organization. To ensure a healthy working culture within a business unit, the organization needs to maintain high values and standards in all of its departments.

Check Your Progress

1. List the categories in which entrepreneurial culture can be divided.
2. What is person culture?
3. State the objective of TQC.

14.3 INTRAPRENEURSHIP-MEANING, IMPORTANCE AND IMPLICATION

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Intrapreneurs are those people who start their own business after having some experience in corporations. These people start their own company either because they want to be independent in working or they feel that their potential is not accepted by their superiors. Intrapreneurs are very similar to entrepreneurs, except that they are also skilful, semi-independent and innovative.

According to Gifford Pinchot III, 'Intrapreneurs are those who create something new whether products, ideas or services for the expansion of the company.'

The concept of entrepreneurship has changed in recent years. Its new class is challenging, and extra competitive due to rigid business environment and availability of finance. Today there is cut-throat competition, as every other day new products are shaped, tested and launched in the market. And it is crucial for an entrepreneur to set his mind in such a way that he can form new ideas regarding the products not available in the market, as it is good for his company. This kind of mind set is called ultrapreneuring. It's a difficult to have innovative ultrapreneurs for an enterprise and to generate new ideas regularly is a challenge for the ultrapreneurs. Ultrapreneur should have the following qualities:

- Achievement
- Action orientation
- Commitment
- Energetic
- Goal oriented
- Growth oriented
- Honesty
- Innovation
- Intelligence
- Leadership
- Risk Taking
- Self confidence

14.3.1 Need, Types, Scope and Features

Let's discuss the need, type, scope and features of intrapreneurs.

Need

It will be incredibly problematic for any corporation if it decides to curb any kind of innovation in the company. There are two consequences of this policy: the company will limit its growth and will fall behind its competitors in the market. The markets in today's world, have become very competitive and it has become imperative for organizations to make sure that their products and services are unique so as to differentiate itself from the sea of competition. This point of difference may be in the form of launching new products, starting new sub-division of the product or service or anything. And this change will have consequences in the long-term growth of the company. Intrapreneurs not only facilitate growth but also give boost to innovation which helps the customers as well as companies. Intrapreneurs also ensure that the company is profited through the perennial pool of talent within its organisation.

There are three components of intrapreneurship: the intrapreneur, the project (in the form of innovative idea) and the mentor (the larger corporation which acts as the aid to the project by providing resources). This multigenerational team will result in either developing the main activity of the organization or the creation of new entity which might benefit the organization.

Types of intrapreneurs

There are various ways of classifying the type of intrapreneurs. One classification is in the form of creaters, doers and implementers. This can be understood as three phases of innovation: the discovery, incubation and execution respectively. The creators ideate new ideas which will then fuel innovation. The doers are focussed on accomplishing stated tasks and the implementers on ensuring that the task gets executed in the right manner and with efficiency. Another way of categorising intrapreneurs is by looking at the types of intrapreneurship. The first kind is that of added value. This type of intrapreneurship initiative is focussed on growth and helps add value to the already established operations of the company. The second type is that of spin-off. Herein, the intrapreneurship projects lead to the creation of a new entity and even though the activities are not related, the parent company may lend help in the form of resources or knowledge.

Scope and Features of an Intrapreneurship

- Intrapreneurship is helpful in promoting creativity in the form of innovation. This is useful in terms of taking risks as well as grooming the intrapreneurs to take on more responsibilities. This will later help the organization create a future pool of talented leaders.
- Through intrapreneurship, there has been seen a cultivation of entrepreneurial skill as well as acceptance of entrepreneurial culture.
- Intrapreneurship projects are beneficial to the companies as it may result in wealth creation. There is good return on the investment.
- The chances of failure of intrapreneurial projects are fairly less in comparison to start-ups since the financial backing by the large organization acts like a cushion.

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- There is enhancement of the skills of the intrapreneur, who works within the organization in the form of increased knowledge about the business as well as entrepreneurial skills.
- The intrapreneurs increase their skills without having to raise capital from the market, which is very difficult. The capital contribution in these projects come from the organizations. The intrapreneurs have agreement with the manager.

14.3.2 Management of Change

Organizations are dynamic entities which have to change with time to ensure its place in the market. Organizations may undertake such transitions through changes in their operations, facilities, documentation or personnel. It is at these times that it is crucial to ensure that the risks related to environment, health and safety are managed properly and not compromised. Management of change is this best practice which ensures an easy transition for companies undergoing change. The principle behind this practice is that of being proactive and ensuring that the workers are not at any undue risk from the changes that are being adopted. Management of change includes the process of reviewing, assessing and authorizing of the proposed changes and its effect on the organizational deign, operations and activities.

There are many benefits of management of change: it reduces the chances of unplanned negative results or impacts, it promotes an adoption of a stable environment, it ensures that the technical changes that are being brought in are appropriate, it increases productivity and efficiency, etc.

14.3.3 Special Programmes of Assistance to Entrepreneurship

We have already discussed the development programmes for entrepreneurs in Unit 11. Here we will highlight some special programmes of assistance to entrepreneurship.

The Indian government has set up special institutions for the promotion of entrepreneurship in the country. They are:

- Small Industries Service Institutes (SISI)
- National Institute for Small Industry Extension and Training (NISIET)
- Entrepreneurship Development Institute of India (EDI)
- National Institute for Entrepreneurship and Small Business Development
- (NIESBUD)
- National Science and Technology Entrepreneurship Development Board
- (NSTEDB)
- IEDs (Institute of Entrepreneurship Development) and CEDs (Centre of Entrepreneurship Development) in different states of India like Orissa, Uttar Pradesh, Andhra Pradesh, Bihar, Assam, Gujarat, Himachal Pradesh, Maharashtra, Rajasthan, Tamil Nadu and so on.

Check Your Progress

4. How are intrapreneurs different from entrepreneurs?
5. State the three components of intrapreneurship.

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14.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. On the basis of graphics and human characteristics, entrepreneurial culture can be divided into different types of sub-cultures, which are as follows:
   - Business ethics
   - Organization's culture
   - TQC
   - Culture of business
2. Person culture is the most individualistic form of culture that exists when individuals are free to express their views. A person culture exists only in a loose form of organization.
3. The main objective of TQC is to ensure total quality for the product. TQC is very useful in improving quality of work life, employee satisfaction and customer satisfaction.
4. Intrapreneurs are very similar to entrepreneurs, except that they are also skilful, semi-independent and innovative.
5. There are three components of intrapreneurship: the intrapreneur, the project (in the form of innovative idea) and the mentor (the larger corporation which acts as the aid to the project by providing resources).

14.5 SUMMARY

- Culture helps differentiate human societies from animal groups. Culture of a group can be described as customs, ideas and attitudes shared by individuals of the group. These customs, ideas and attitudes are transmitted from one generation to another by means of a learning process and not through biological inheritance.
- Culture basically consists of two different elements, one is called material culture and other is known as non-material culture.
- Entrepreneurial culture can be defined as a combination of tangible man-made objects and intangible concepts. Examples of tangible man-made objects include automobiles, clothing, furniture, buildings and tools. On the

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other hand, laws, morals and knowledge are the examples of intangible concepts.

- On the basis of graphics and human characteristics, entrepreneurial culture can be divided into different types of sub-cultures, which are as follows:
    - o Business ethics
    - o Organization's culture
    - o TQC
    - o Culture of business
- Intrapreneurs are those people who start their own business after having some experience in corporations. These people start their own company either because they want to be independent in working or they feel that their potential is not accepted by their superiors. Intrapreneurs are very similar to entrepreneurs, except that they are also skilful, semi-independent and innovative.
- It will be incredibly problematic for any corporation if it decides to curb any kind of innovation in the company. There are two consequences of this policy: the company will limit its growth and will fall behind its competitors in the market.
- Intrapreneurs not only facilitate growth but also give boost to innovation which helps the customers as well as companies. Intrapreneurs also ensure that the company is profited through the perennial pool of talent within its organisation.
- There are three components of intrapreneurship: the intrapreneur, the project (in the form of innovative idea) and the mentor (the larger corporation which acts as the aid to the project by providing resources).
- There are various ways of classifying the type of intrapreneurs. One classification is in the form of creaters, doers and implementers. Another way of categorising intrapreneurs is by looking at the types of intrapreneurship. The first kind is that of added value. This type of intrapreneurship initiative is focussed on growth and helps add value to the already established operations of the company. The second type is that of spin-off.
- Organizations are dynamic entities which have to change with time to ensure its place in the market. Organizations may undertake such transitions through changes in their operations, facilities, documentation or personnel. It is at these times that it is crucial to ensure that the risks related to environment, health and safety are managed properly and not compromised. Management of change is this best practice which ensures an easy transition for companies undergoing change.

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- The Indian government has set up special institutions for the promotion of entrepreneurship in the country. They are: Small Industries Service Institutes (SISI), National Institute for Small Industry Extension and Training (NISIET), Entrepreneurship Development Institute of India (EDI), National Institute for Entrepreneurship and Small Business Development (NIESBUD), National Science and Technology Entrepreneurship Development Board (NSTEDB), IEDs (Institute of Entrepreneurship Development) and CEDs (Centre of Entrepreneurship Development) in different states of India.

14.6 KEY WORDS

- **Culture of a group:** It can be described as customs, ideas and attitudes shared by individuals of the group.
- **Entrepreneurial culture:** It can be defined as a combination of tangible man-made objects and intangible concepts.
- **Business ethics:** It is the method of dealing with those business problems that are unclear in nature.
- **TQC:** It can be defined as a sum of norms, beliefs and values that control the behaviour of individuals and groups within the organization.
- **Intrapreneurs:** It refers to those people who start their own business after having some experience in corporations.

14.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the different elements of culture?
2. What does an entrepreneurial culture specify?
3. List the different types of organizational cultures.
4. Mention the qualities an ultrapreneur should have.
5. What is management of change?
6. List some of the special programmes of assistance to entrepreneurship.

Long Answer Questions

1. 'On the basis of graphics and human characteristics, entrepreneurial culture can be divided into different types of sub-cultures.' Describe them.
2. Explain the need, types, scope and features of intrapreneurs.

14.8 FURTHER READINGS

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