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**ENTREPRENEURSHIP  
DEVELOPMENT**



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<b>ENTREPRENEUR AND ENTREPRENEURSHIP</b>	

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## 1.0 Learning Objectives

After reading this lesson, you will be able to:

- Define entrepreneur and entrepreneurship.
- Understand the features of an entrepreneur.



- Differentiate between entrepreneur and manager.
- Describe the various types of entrepreneurs.
- Explain the nature and characteristics of entrepreneurship.
- Understand the role of entrepreneurship in the economic development.

## 1.1 Introduction

Entrepreneurs play a vital role in the economic development of a country. Economic development of a country depends primarily on its entrepreneurs. An entrepreneur is often considered as a person who sets up his own business or industry. He has initiative, drive, skill and spirit of innovation who aims at high goals. The entrepreneur is the individual that identifies the opportunity, gathers the necessary resources and is ultimately responsible for the performance of the organization. Entrepreneurs are action oriented, highly motivated individuals who take risks to achieve goals.

Entrepreneurship is the purposeful activity of an individual or a group of associated individuals, undertaken to initiate, maintain or aggrandize profit by production, or distribution of economic goods and services. Entrepreneurship is very often associated with adventurism, risk bearing, innovating creativity etc. It is concerned with making dynamic changes in the process of production, innovation in production, new usage for materials etc. It is a mental attitude to take calculated risks with a view to attain certain objectives. It also means doing something in a new and better manner.

## 1.2 Concept of Entrepreneur

The story of defining entrepreneur and entrepreneurship will sound like the story of six blind men describing an elephant. There is hardly any commonly agreed upon definition among economic pundits.

The word “**entrepreneur**” is derived from the French word *entreprendre* which means to initiate or undertake. In the early sixteenth century, the Frenchmen who organized and led military expeditions were referred to as “entrepreneurs”. The term entrepreneur was applied to business in the early eighteenth century by French Economist **Richard Cantillon**. According to him, the entrepreneur buys factor services at certain prices with a view to sell their products at uncertain prices in the future. **Richard Cantillon** conceived of an entrepreneur as a bearer of non-insurable risk.



Another Frenchman, **J.B. Say**, expanded Cantillon's ideas and conceptualized the entrepreneur as an organizer of a business firm, central to its distributive and production functions. Beyond stressing the entrepreneur's importance to the business, Say did little with his entrepreneurial analysis. According to **J.B. Say**, an entrepreneur is the economic agent who unites all means of production, the labour force of the one and the capital or land of the others and who finds in the value of the products his results from their employment, the reconstitution of the entire capital that he utilizes and the value of the wages, the interest and the rent which he pays as well as profit belonging to himself. He emphasized the functions of co-ordination, organization and supervision. Further, it can be said that the entrepreneur is an organizer and speculator of a business enterprise. The entrepreneur lifts economic resources out of an area of lower into an area of high productivity and greater yield.

**The New Encyclopedia Britannica** considers an entrepreneur as an individual who bears the risk of operating a business in the face of uncertainty about the future conditions. Leading economists of all schools, including **Karl Marx** have emphasized the contribution of the entrepreneurs to the development of economies, but **Joseph A. Schumpeter** who argues that the rate of growth in an economy depends to a great extent on the activities of entrepreneurs, has probably put greater emphasis on the entrepreneurial function than any other economist.

In the words of **Joseph A. Schumpeter**, "The entrepreneur in an advanced economy is an individual who introduces something new in the economy – a method of production not yet tested by experience in the branch of manufacture concerned, a product with which consumers are not yet familiar, a new source of raw material or of new markets and the like". The function of an entrepreneur according to him is to "reform or revolutionize the pattern of production by exploiting an invention or more generally, an untried technological possibility for producing a new commodity". According to **Schumpeter**, an entrepreneur is an innovator, who introduces something new in the economy. Innovation may be: (a) introduction of a new product, (b) introduction of new methods of production, (c) developing new markets and finding fresh sources of raw materials, and (d) making changes in the organization and management.

**Knight** described entrepreneurs to be a specialized group or persons, who bear uncertainty; and uncertainty is defined as the risk which cannot be calculated. The entrepreneur, according to **Knight**, is



the economic functionary who undertakes such responsibility which, by its very nature, cannot be insured or salaried. He also guarantees specified sums to others in return for assignments made to them.

**Peter F. Drucker**, in his book *“Innovative Entrepreneurs”* defines entrepreneurs as innovators. Entrepreneurs search for change and exploit opportunities. According to him “Innovation is the specific tool of entrepreneurs, the means by which they exploit changes as an opportunity for a different business or a different service. It is capable of being presented as a discipline, capable of being learned, capable of being 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”. He further said that an entrepreneur is one who always searches for changes, responds to it, and exploits it as an opportunity.

**Cunningham and Lischerson** in their recent work have described six possible schools of thought on entrepreneurs. The first school of thought i.e. ‘Great Person School’ says that an entrepreneur is born with an intuitive ability – a sixth sense and this sense helps him in startup stage. The second school of thought, i.e. ‘Psychological Characteristics School’ explains that entrepreneurs have unique values attitudes, and needs which drive them and help them especially in start-up stage. The third school, i.e. ‘Classical School of Thought’ says that central characteristic of entrepreneurial behavior is innovation. This characteristic helps the entrepreneur much in start-up and early growth. ‘Management School’ is the fourth school of thought and it says entrepreneurs are organizers of economic venture and they organize, own, manage and assume its risk. Such functional orientation helps them in early growth and maturity. The fifth school of thought is the ‘Leadership School’. According to this school, entrepreneurs are leaders of people and they have the ability to adopt their style to the needs of people. Such leadership personality suits them most during early growth and maturity situations. ‘Intrapreneurship School’ is the sixth school of thought. Intrapreneurship is the act of developing independent units, to create market and expand services within the organization. Intrapreneurship is needed by an entrepreneur during the situation of maturity and change.

Whatever is the definition, across the world entrepreneurs have been considered instrumental in initiating and sustaining socio-economic development. There are evidences to believe that countries which have proportionately higher, percentage of entrepreneurs in their population have developed much faster as compared to countries which have lesser percentage of them in the society, discover new



sources of supply of materials and markets and they establish new and more effective forms of organizations. Entrepreneurs perceive new opportunities and seize them with super normal will power and energy, essential to overcome the resistance that social environment offers. In sum, the concept of entrepreneurs is intimately associated with the three elements-risk bearing, organizing and innovating.

### **1.2.1 Features of an Entrepreneur**

If we go through the business history of successful entrepreneurs in our country, we come across the names of **Tata, Birla, Gulshan Kumar, Modi, Kirlosker, Dalmia and others** who started their business with small size and made good fortunes. The scanning of their personal features shows that there are certain characteristics of entrepreneurs which are found usually prominent in them. Successful entrepreneurs are action-oriented, they have the ability to visualize the steps from idea to actualization. They are both thinkers and doers, planners and workers, get involved-they adopt a hands-on approach, can tolerate ambiguity-enterprise always consists of action in uncertainty, accept risk but understand and manage it; overcome rather than avoid mistakes – they don't admit they are beaten, see themselves as responsible for their own destiny-they are dedicated, setting self-determined goals and believe in creating markets for their ideas, not just in responding to existing market demands.

An entrepreneur is a job-giver and not a job-seeker. This means that he is his own boss. The characteristics which make him his own boss are given below:

- Strong achievement orientation.
- Unwavering determination and commitment.
- Self-reliance and independence.
- Hunger for success.
- Self-confidence and self-faith.
- Sustained enthusiasm.
- Single-mindedness.
- Strong reality orientation.
- Willingness to accept responsibility.
- Courage.
- Ability to survive defeat.



- Become wealthy and stay humble.

An entrepreneur is a highly achievement oriented, enthusiastic and energetic individual.

### 1.2.2 Entrepreneur vs. Manager

The entrepreneur is a person who is motivated to satisfy a high need for achievement in innovative and creative activities. His creative behavior and innovative spirit which forms a process of an endless chain is termed as entrepreneurship. It is not enough for the entrepreneur to build up the process, but equally important task for him is to manage the business. He performs entrepreneurial vis-a-vis managerial functions. The entrepreneur enters at a transitional stage in which what is initially with innovation becomes a routine for him the transition from an entrepreneurship to management. Also, the emphasis switches from techniques and analytical methods to insight and to involvement with people. The entrepreneur perceives and exploits opportunity, and the subsequent steps necessary for organization are pertinent, to management.

The entrepreneur differs from the professional manager in that he undertakes a venture for his personal gratification. As such he cannot live within the framework of occupational behavior set by others. He may engage professional manager to perform some of his functions such as setting of objectives, policies, procedures, rules, strategies, formal communication network. However, the entrepreneurial functions of innovation, assumption of business risk and commitment to his vision cannot be delegated to the professional manager. Failure to the professional executive may mean a little more than locating a new job perhaps even at a higher salary, whereas failure of an entrepreneur in his efforts would mean a devastating loss to his career. The professional manager has to work within the framework of policy guidelines laid down by the entrepreneur. This distinction between entrepreneur and the professional (traditional) manager is presented in Table I.

**Table-1. Distinctive Features of Traditional Managers and the Entrepreneur**

Features	Managers	Entrepreneur
<b>Primary Motives</b>	Want promotion and traditional corporate rewards. Power-motivated.	Wants freedom, goal oriented Self-reliant, and self-motivated.
<b>Time</b>	Respond to quotas and Budgets,	End goals of 5-10 year growth of





<b>Orientation</b>	weekly, monthly, quarterly, annual planning horizons, the next promotion or transfer.	business in view as guides. Takes action now to move the next step along way
<b>Action</b>	Delegate action. Supervising and reporting take most of energy their work.	Gets hands dirty. May upset employees by suddenly doing.
<b>Skills</b>	Knows business intimately. More school trained. Abstract analytical tools people-management and political skills.	Professional training. Often business business acumen than managerial or political skill. Often technically trained if in technical business.
<b>Courage and Destiny</b>	Sees others in charge of his or her destiny. Can be forceful and ambitious. But may be fearful of others' ability in case of optimism.	Self-confident, optimistic, courageous.
<b>Attention</b>	Primly on events inside corporation.	Primarily on technology and market place.
<b>Risk</b>	Careful	Like moderate risk. Invests heavily, but expects to succeed.
<b>Market Research</b>	Has market studies done to discover needs and guide product conceptualization.	Creates needs. Creates products that often can't be tested with market research-potential customers don't yet understand them. Talks to customers and forms own opinions.
<b>Status</b>	Cares about status symbols if job is getting done.	Happy sitting on an orange crate
<b>Failure and</b>	Strives to avoid mistakes and surprises.	Deals with mistakes and failures as



<b>Mistakes</b>	Postpones recognizing failure.	learning experiences.
<b>Decisions</b>	Agrees with those in power. Delays decision until he gets a feel of what bosses want.	Follows private vision. Decisive and action-oriented.
<b>Who they Serve?</b>	Pleas others.	Pleases self and customers.
<b>Attitude Toward the system</b>	Sees system as nurturing and protective, seeks position within it.	May rapidly advance in a system, when frustrated; reject the system and form his or her own.
<b>Problem-solving Style</b>	Works out problems within the system.	Escapes problems in large and formal structures by leaving and starting over his own.
<b>Family History</b>	Family members worked for large organizations.	Entrepreneurial small-business, professional, or agricultural background.

### 1.2.3 Types of Entrepreneurs

**Schumpeter** made the entrepreneur the adventurous innovator who acting on his own account, introduces changes that others do not dare to experiment with. Other writers have, however, identified some other categories of entrepreneurs.

**Arthur H. Cole** distinguishes between empirical, rational and cognitive entrepreneurs. The empirical entrepreneur hardly introduces anything revolutionary and follows the principle of rule of thumb. The rational entrepreneur is well informed about the general economic conditions and introduces changes that look more revolutionary. The cognitive entrepreneur is well informed, draws upon the advice and services of experts and introduces changes that reflect complete break from the existing scheme of things.

In a study of **American Agriculture**, **Clarence Danhof** classifies entrepreneurs into four types- innovative, imitative, fabian and drone. The innovating entrepreneur is one who assembles and



synthesizes information and introduces novel combinations of factors. He is an aggressive figure and an industrial leader. The imitative entrepreneur is also known as the adoptive entrepreneur. He simply adopts successful innovations introduced by other innovators. The fabian entrepreneurs is timid and cautious. He will imitate other innovations only if he is certain that failure to do so may damage his business. Finally there is the drone entrepreneur. His entrepreneurial activity may be restricted to just one or two innovations. He refuses to adopt changes in production even at the risk of reduced returns.

This classification of **Danhof** brings into focus two important aspects:

- It shows that an economy which is making a lot of technical advancement has in its ranks a large number of innovating and adoptive entrepreneurs and less number of fabians and drones.
- Technological advancement may not take place even if innovators are present, if the actual control and ownership of production is in the hands of fabians or drones.

Another classification of entrepreneurs is between private and public entrepreneurs. Private entrepreneur is motivated by profit and as such would not enter those sectors of the economy in which prospects of monetary rewards are not bright. In general, infrastructure industries fall under this category. For example electricity generation and distribution is Government owned. This forces the Government to take the initiative to start enterprises in these sectors. Thus, we have the category of public entrepreneurs. In the less developed countries the entrepreneurial functions of the Government has greatly widened due to the lack of sufficient private entrepreneurs.

Another classification based on the scale of enterprise is between small scale and large scale enterprises. This classification is especially relevant in the less developed countries. Private enterprise is usually found in households, small scale and medium scale industries. The small entrepreneur does not possess the necessary talents and resources to initiate large scale production and introduce revolutionary technological changes. In the developed countries most entrepreneurs deal with large scale enterprises. They possess the financial wherewithal and the necessary expertise to initiate large scale enterprises and introduce novel technical changes. The result is the developed countries are able to sustain and develop a high level of technical progress. It is this classification which has led to the wide technological gap between the developed and the less developed countries.



In the initial stages of economic development, entrepreneurs tend to have less initiative and drive. As development proceeds, they become more innovating and enthusiastic. Similarly, when entrepreneurs are shy and humble the environment is underdeveloped. Business environment becomes healthy and developed when entrepreneurs are innovating.

- **Innovating entrepreneurs:** Innovative entrepreneurship is characterized by aggressive assemblage of information and the analysis of results derived from sound combination of factors. Persons of this type are generally aggressive in experimentation and cleverly put attractive possibilities into practice. An innovating entrepreneur sees the opportunity for introducing a new technique or a new product or a new market. He or she may raise money to launch an enterprise, assemble the various factors, choose top executives and set the organization going. Schumpeter's entrepreneur was of this type. Such an entrepreneur introduces new products and new methods of production, opens new markets and re-organizes the enterprise.

Among the different types of entrepreneurs, the innovating entrepreneur is the most vigorous type of entrepreneur. Innovating entrepreneurs are very commonly found in developed countries. There is dearth of such entrepreneurs in underdeveloped countries. A country with little or no industrial tradition can hardly produce innovating entrepreneurs. Such entrepreneurs can emerge and work only when a certain level of development is already achieved and people look forward to change and progress. Innovating entrepreneurs played the key role in the rise of modern capitalism through their enterprising spirit, hope of money making, ability to recognize and exploit opportunities, etc.

- **Adoptive or imitative entrepreneurs:** These kinds of entrepreneurs are characterized by readiness to adopt successful innovations created by innovative entrepreneurs. These type of entrepreneur are revolutionary entrepreneurs with the different that instead of innovating the changes themselves, they just imitate the technology and techniques innovated by others. These entrepreneurs are most suitable for developing countries because such countries prefer to imitate the technology, knowledge and skill already available in more advanced countries. The Cochin Shipyard is a good example of the result of imitative entrepreneurship. The Shipyard has been constructed using the innovative technology provided by the Mitsubishi Heavy Industries Ltd. of Japan. Imitative entrepreneurs are most suitable for the underdeveloped nations because in these nations people prefer to imitate the technology, knowledge and skill already available in more advanced countries.



In highly backward countries there is shortage of imitative entrepreneurs also. People who can imitate the technologies and products to the particular conditions prevailing in these countries are needed.

Sometimes, there, is a need to adjust and adopt the new technologies to their special conditions. Imitative entrepreneurs help to transform the system with the limited resources available. However, these entrepreneurs face lesser risks and uncertainty than innovative entrepreneurs. While innovative entrepreneurs are creative, imitative entrepreneurs are adoptive.

Imitative entrepreneurs are also revolutionary and important. The importance of these humbler entrepreneurs who exploit possibilities as they present themselves and mostly on a small scale must not be under-estimated. In, the first place, such adaptation requires no mean ability. It often involves what has aptly been called subjective innovation that is the ability to do things which have not been done before by the particular industrialist, even though, unknown to him, the problem may have been solved in the same way by others. By western standards, an imitative entrepreneur may be a pedestrian figure, an adopter and imitator rather than a true innovator. He is more an organizer of factors of production than a creator. But in a poor country attempting to industrialize, he is nevertheless a potent change producing figure. He can set in motion the chain reaction' which leads to cumulative progress. This humbler type of entrepreneur is important in under developed countries for another reason. These countries are placing great emphasis in their economic planning on small scale industries and decentralized industrial structure.

- **Fabian entrepreneurs:** Entrepreneurs of this type are very cautious and skeptical while practicing any change. They have neither the will to introduce new changes nor the desire to adopt new methods innovated by the most enterprising entrepreneurs. Such entrepreneurs are shy and lazy. Their dealings are determined by custom, religion, tradition and past practices. They are not much interested in taking risk and they try to follow the footsteps of their predecessors.
- **Drone entrepreneurs:** Drone entrepreneurship is characterized by a refusal to adopt and use opportunities to make changes in production methods. Such entrepreneurs may even suffer losses but they do not make changes in production methods. They are laggards as they continue to operate in their traditional way and resist changes. When their product loses marketability and their operations become uneconomical they are pushed out of the market. They are conventional in the



sense that they stick to conventional products and ideas. The traditional industries of Kerala are characterized by drone entrepreneurs. The coir and bamboo industries are still in the hands of laggards who refuse to innovate.

### 1.3 Concept of Entrepreneurship

Like other economic concepts, entrepreneurship has long been debated and discussed. It has been used in various ways and in various senses, while some call entrepreneurship as ‘risk-bearing’ others view it innovating and yet others consider it ‘thrill-seeking’.

According to **Higgins**, “Entrepreneurship is meant the function of seeking investment and production opportunity, organizing an enterprise to undertake a new production process, raising capital hiring labour, arranging the supply of raw materials, finding site, introducing a new technique and commodities, discovering new sources of raw materials and selecting top managers of day-to-day operations of the enterprise”. In this definition entrepreneurship is described as the function of handling economic activity, undertaking risk, creating something new and organizing and coordinating resources.

At a conference on entrepreneurship in the United States, entrepreneurship was defined as an attempt to create value through recognition of business opportunity, the management of risk-taking appropriate to the opportunity, and through the communicative and management skills to mobilize human, financial, and material resources necessary to bring a project to fruition. This definition recognizes that entrepreneurship is both an art as well as a science which involves the fusion of capital, technology and human talent and is a dynamic and risky process.

However, it is a young or immature science. In order to build the body of knowledge that underlies the art of entrepreneurship we must create academic models that can successfully be applied in industry. The art and science of entrepreneurship are complementary to each other and, therefore, require simultaneous advances in both theory as well as practice.

According to **Diamond**, “Entrepreneurship is equivalent to enterprise which involves the willingness to assume risks in undertaking an economic activity particularly a new one. It may involve an innovation but not necessarily so. It always involves risk-taking and decision-making, although neither risk nor decision-making may be great significance”. In this definition, entrepreneurship is used to refer to the



qualities required to innovate, start a new enterprise, accept the challenge and bear the risk. Few individuals have these qualities and, therefore, entrepreneurs are found in limited numbers in any society.

According to **A.H. Cole** “Entrepreneurship is the purposeful activity of an individual or a group of associated individuals, undertaken to initiate, maintain or aggrandize profit by production or distribution of economic goods and services”.

**Jaffrey A. Timmons** defined entrepreneurship as “the ability to create and build something from practically nothing. Fundamentally, a human creative activity, it is finding personal energy by initiating, building and achieving an enterprise or organization rather than by just watching, analyzing or describing one. It requires the ability to take calculated risk and to reduce the chance of failure. It is the ability to build a founding team to complement the entrepreneur’s skills and talents. It is the knack for sensing an opportunity where others see chaos, contradiction and confusion. It is the know-how to find, Marshall, and control resources and to make sure the venture does not run out of money when it is needed most”.

According to **Peter F. Drucker**, “Entrepreneurship is neither a science nor an art. It has a knowledge base. Knowledge in entrepreneurship is a means to an end. Indeed, what contributes knowledge in practice is largely defined by the ends, that is, by the practice”. In Drucker’s view, entrepreneurship is considered less risky, if the entrepreneur is methodical and does not violate elementary and well known rules.

In all above definitions, entrepreneurship refers to the functions performed by an entrepreneur in establishing an enterprise. Just as management is regarded as what managers do, entrepreneurship may be regarded as what entrepreneurs do. In other words, entrepreneurship is the act of being an entrepreneur. Entrepreneurship is a process involving various actions to be undertaken to establish an enterprise. It is, thus, process of giving birth to a new enterprise.

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enterprise. It is, thus, process of giving birth to a new enterprise. Innovation and risk bearing are regarded as the two basic elements involved in entrepreneurship.

Though the term entrepreneur is often used interchangeably with entrepreneurs, yet they are conceptually different. The relationship between the two is just like the two sides of the same coin as depicted in the following table.

**Relationship between Entrepreneur and Entrepreneurship**

<b>Entrepreneur</b>	<b>Entrepreneurship</b>
Person	Process
Organizer	Organization
Innovator	Innovation
Risk-bearer	Risk-baring
Motivator	Motivation
Creator	Creation
Visualiser	Vision
Leader	Leadership
Imitator	Imitation

Thus, entrepreneurship is concerned with the performance and coordination of the entrepreneurial functions. This also means that entrepreneur precedes entrepreneurship.

### **What entrepreneurship involves?**

Entrepreneurship involves the following:

- Confidence in an idea and a willingness to accept the hard work necessary for turning the creativity of dreams into reality.
- Seeing the opportunity presented by change that others have not had the courage to act on.
- Taking controllable risks rather than gambling or relying on sheer luck.





- Costs other than money; time, energy, reputation, emotional drains.
- Reality testing: recognizing realistic limits imposed by the economy or physical resources available.
- Knowing and understanding customers and their needs.
- A basic understanding of business and products or services.
- Keeping and interpreting business records.
- Careful planning to reduce risks.
- Knowing the actions, strengths and weaknesses of competitors.
- Having right location, and also right size and right price or lease rate for that location.
- Building a team of people with complementary skills and talents.
- Sensing opportunities, while others see chaos, contradiction, and confusion.
- Finding and controlling resource (often owned by others) to pursue the opportunity.
- Having a vision and then having the passion, commitment, and motivation to transmit this.
- Vision to others (employees, partners, suppliers and customers).
- A willingness to take responsibility and ability to put mind to task and see it through from inception to completion.

### 1.3.1 Nature and Characteristics of Entrepreneurship

Entrepreneurship is a multi-dimensional concept and it is unnecessary to consider many factors and perspectives. The distinctive features of entrepreneurship are as follows:

- **Innovation:** The process of commercializing an invention is innovation. For example, steam as an alternative source of energy was invented as early as AD 100. Later, in 1712, when it was used to run engines then the process was called innovative. In simple words, in business activity, novelty may take any one or a combination of the following:
- New products ;
  - New methods of production ;
  - New markets ;
  - New sources of raw material ; or
  - New forms of organization.



Innovation is a critical aspect of entrepreneurship. Entrepreneurs always try to create new and different values and get satisfaction in doing so. They try to convert a material into a resource or, combine the existing resources in a new and more productive manner. The act of innovation thus provides resources with a new capacity to create wealth.

- **Motivation:** Motivation comes from the word ‘motive’ (or goal). It means the urge in an individual to achieve a particular goal. In other words, it is the need to achieve that motivates a person. You may find many people with sufficient financial resources and family support who are interested in independent ventures. Yet, very few actually start their business. Why is it so? Because they are comfortable in doing routine jobs and have no higher goals in life. They lack ‘motivation’. Entrepreneurs generally are highly active. They struggle constantly to achieve something better than what they already have. They like to be different from others and are ready to work hard to reach their goal.

Persons experiencing constant need to achieve always try to understand their strengths and weaknesses. This enables them to seek external help whenever needed.

Let us take a look at the ‘Vadilal’ group which is household name today in Gujarat. ‘Vadialal Ice Cream’ is a premier brand in the consumer market. You may be surprised to know that Ramachandra Gandhi and Laxman Gandhi, the two brothers who founded the Vadilal empire, could not even complete their school education. They started in a small way by selling homemade ice cream in the city of Ahmedabad. Now, Vadilal is the largest ice cream company in the country.

How did they do it? They did not stop thinking big. They had the courage to do what they wanted to. Entrepreneurial persons seek rewards or returns earned through their own efforts and do not depend upon ‘luck’. They do not like to be idle.

- **Risk Taking:** Risk-taking implies taking decisions under conditions where the reward on a certain action is known, but the occurrence of the event is uncertain. While doing so, an entrepreneur becomes responsible for the result of the decision. This responsibility however cannot be insured against failure.

Imagine that you are a qualified pharmacist and that you have got a large sum of money from your parents. Which of the following options would you choose?

- Invest in a bank deposit with 8 per cent annual interest;



- Invest in a company with a possible return of 15 per cent;
- Start a medical shop in your locality (because people there have to travel a long distance to get medicines) with a fairly good chance of marking an immediate return of around 10 percent. (You are also aware that the business is sustainable and can bring in more returns say 20,30 or 50% in future if you put in your time and effort);
- Try your luck in the share market.

Clearly, option 'c' calls for an entrepreneurial quality. Remember that successful entrepreneurs usually choose the moderate or middle path. They are not gamblers. At the same time, they are not afraid of taking a decision if there is a reasonable chance of success.

You must be aware that businessmen spend considerable amount of time in planning their enterprises. They study the market technology, examine and re-examine the demand, the prices, machinery and processes involved, make detailed enquiries about sources of finance and think about other business lines. Why do you think they do through all these processes? In order to minimize the risks involved and avoid difficulties that may arise in the future, as far as possible.

- **Organization Building:** According to **Harbison** entrepreneurship implies the skill to build an organization. Organization building ability is the most critical skill required for industrial development. This skill means the ability to 'multiply oneself by effectively delegating responsibility to others. Unlike Schumpeter, Harbison's entrepreneur is not an innovator but an organization builder who harnesses the new ideas of different innovators to the rest of the organization. Entrepreneurs need not necessarily be the men with ideas or men who try new combinations of resources but they may simply be good leaders and excellent administrators.
- **Managerial Skills and Leadership:** According to **Hoselitz**, managerial skills and leadership are the most important facets of entrepreneurship. Financial skills are only of secondary importance. He maintains that a person who is to become an industrial entrepreneur must have more than he drives to earn profits and amass wealth. He must have the ability to lead and manage. He identifies three types of business leadership, namely merchant money lenders, managers and entrepreneurs. The function of the first group is market oriented, that of the second is authority-oriented while the third group has an addition to these a production-orientation.



The commodity with which a money lender deals is acceptable to everyone but an industrial entrepreneur creates his own commodity and its acceptability is uncertain. Therefore, the entrepreneur assumes more risk than a trader or a money lender. Only a strong desire to make profit is not enough to succeed in entrepreneurship. Entrepreneurship can develop in a society where its culture permits a variety of choices and where social processes are not rigid. The social conditions should encourage the development of enterprise. There are innumerable cases, in entrepreneurial history, of firms, which failed because their founders could not function as managers or feared to enlist the services of managers when required.

### **1.3.2 Role of Entrepreneurship in Economic Development**

The entrepreneurship has been identified by many economists as a vital force in the process of industrialization in particular and economic development in general. Economic development essentially means a change. But, at the same time, it is very difficult to define precisely the phrase 'economic development'. One should realize that the term economic development does not convey the idea of total development of the society. It only focuses itself on one aspect and one dimension of general development. Economic development can be defined as a move towards even more efficient and differentiated methods of supplying people with the requirements for survival and improvement.

Many a time economic development is interpreted as synonymous with industrialization because it is viewed by the poor regions as a superior way of life. But economic development cannot be equated with industrialization. When economic development is analyzed with the yard stick of extent of industrialization, it implicitly undermines the importance of primary sector like agriculture. The high dependency ratio of people on the primary sector is not the cause of underdevelopment but the consequence of it. These two sectors are complementary to each other in the development process. Moreover, economic development is much more than industrialization, it is an upward movement of the entire social system. Economic development includes increase in productivity, social and economic equalization, improved institutions, and attitudes, and a rationally coordinated system of policy measures and removal of undesirable conditions and systems that perpetuated a state of underdevelopment.



It appears that economic development involves something more than economic growth and it includes both growth and change. Moreover, economic development is not only a quantitative phenomenon but has qualitative dimensions too.

The criterion of per capita income can be considered as a good indicator of regional variations in economic development. As the economic development is essentially a process the increase in per capita income should not appear as a temporary or short sustained phenomenon. Of course, the increase in per capita income can be considered as the primary criterion for measuring the extent of development in an area. There are other sub-criteria which have to be considered along with the primary criterion. The nature of distribution of income in the society is an integral part of the development. The secondary objectives like level of consumption, level of employment, diversification against concentration of the economy are also important.

Economic development is not to be considered as an end in itself, but is a means to an end. Economic development is concerned, ultimately, with the achievement of better nourishment, better education, better health, better living conditions and an expanded range of opportunities in work and leisure for the people. Therefore, a rise in real per capita income is a relevant criterion to judge the extent of development in a region as it is a means for the attainment of desired standards in nourishment, education, health, and living conditions.

The entrepreneur is the key to the creation of new enterprises that energise the economy and rejuvenate the established enterprises that make up the economic structure. Entrepreneurs initiate and sustain the process of economic development in the following ways:

- **Capital formation:** Entrepreneurs mobilize the idle savings of the public through the issues of industrial securities. Investment of public savings in industry results in productive utilization of national resources. Rate of capital formation increases which is essential for rapid economic growth. Thus, an entrepreneur is the creator of wealth.
- **Improvement in per capita income:** Entrepreneurs locate and exploit opportunities. They convert the talent and idle resources like land, labour and capital into national income and wealth in the form of goods and services. They help to increase net national product and per capita income in the country, which are important yardsticks for measuring economic growth.



- **Improvement in living standards:** Entrepreneurs set up industries which remove scarcity of essential commodities and introduce new products. Production of goods on mass scale and manufacture of handicrafts, etc., in the small scale sector help to improve the standard of life of a common man. These offer goods at lower costs and increase variety in consumption.
- **Economic independence:** Entrepreneurship is essential for national self-reliance. Industrialists help to manufacture indigenous substitutes of hitherto imported products thereby reducing dependence on foreign countries. Businessmen also export goods and services on a large scale and thereby earn the scarce foreign exchange for the country. Such import substitution and export promotion help to ensure the economic independence of the country without which political independence has little meaning.
- **Backward and forward linkages:** An entrepreneur initiates change which has a chain reaction. Setting up of an enterprise has several backward and forward linkages. For example, the establishment of a steel plant generates several ancillary units and expands the demand for iron ore, coal, etc. These are backward linkages. By increasing the supply of steel, the plant facilitates the growth of machine building, tube making, utensil manufacturing and such other units. Entrepreneurs create an atmosphere of enthusiasm and convey a sense of purpose. They give an organization its momentum. Entrepreneurial behavior is critical to the long term vitality of every economy. The practice of entrepreneurship is an important to established firms as it is to new ones.
- **Generation of Employment:** At the beginning of seventh five year plan the backlog of unemployment was estimated to be around 44 million persons. At present, the number of unemployed in the country is far greater than what it was during 1985. Emphasis on modernization which usually results in automation, use of high technology, and technology up gradation initiated during 1980s and structural changes introduced by the Government during 1990's are likely to give much rise to capital-intensive rather than labour intensive industry. It is feared that there will be very little additional job opportunities within the fold of organized public and private sectors. Most of the job opportunities in future are likely to be emerging from informal and unorganized sectors of economy. Entrepreneurship development training which helps in strengthening informal and unorganized sector is expected to motivate enterprising people to opt for self-employment and



entrepreneurial career. It will therefore, help in solving the problem of increasing unemployment to some extent.

- **Harnessing Locally Available Resources and Entrepreneurship:** India is considered to be very rich in natural resources. In spite of about five decades of planned development a large number of states have remained economically backward. A few large scale industries started by entrepreneurs from outside the state in an economically backward area may help as model of pioneering efforts, but ultimately the real strength of industrialization in backward areas depends upon the involvement of local entrepreneurship in such activities: Increased activities of local entrepreneurs will also result in making. Use of abundantly available local resources.
- **Balanced Regional Growth:** Medium and large scale industries can only be started with huge investment which is either available with well-established industrial houses or need to be drawn from public exchequer. Also, promotion of such industries does not help in reducing disparities of income and wealth. On the other hand, an important advantage of small scale enterprises is that they can be started with meager financial resources and little or no previous experience or entrepreneurial background.
- **Reducing Unrest and Social Tension amongst Youth:** Many problems associated with youth unrest and social tensions are rightly considered to be due to youth not being engaged in productive work. In the changing environment where we are faced with the problem of recession in wage employment opportunities, alternative to wage career is the only viable option. The country is required to divert the youth with latent entrepreneurial traits from wage career to self-employment career. Such alternate path through entrepreneurship could help the country in defusing social tension and unrest amongst youth.
- **Innovations in Enterprises:** Business enterprises need to be innovative for their survival and better performance. It is believed that smaller firms have relatively higher necessity and capability to innovate. The smaller firms do not face the constraints imposed by large investment in existing technology. Thus they are both free and compelled to innovate: The National Science Foundation, an organization in USA found that small companies produce four times more innovations per research dollar than do bigger companies. Entrepreneurship development programmes are aimed at



accelerating the pace of small firms' growth in India. Increased number of small firms is expected to result in more innovations and make the Indian industry compete in international market.

### **1.4 Check Your Progress**

1. Which one of the following is a feature of entrepreneurship?
  - (a) Risk Taking
  - (b) Innovative
  - (c) Both a & b
  - (d) None of the above
2. Which one is the role of entrepreneurship?
  - (a) Capital Formation
  - (b) Balanced Regional Growth
  - (c) Create Employment opportunities
  - (d) All of the above
3. Entrepreneurs can be classified into.....?
  - (a) Innovative,
  - (b) Imitative,
  - (c) Fabian and drone
  - (d) All of the above
4. Who uses the word 'Entrepreneur' first time in economic activities?
  - (a) Richard Cantillon
  - (b) Mark Casson
  - (c) Joseph A. Schumpeter
  - (d) None of the above
5. Is manager and entrepreneur are same?
  - (a) Yes, they are same because their qualities are same.
  - (b) No, they are different because their qualities are different.
  - (c) Cannot say.
  - (d) None of the above





6. Entrepreneurship involves the following:

- (a) Taking controllable risks rather than gambling or relying on sheer luck.
- (b) Knowing and understanding customers and their needs.
- (c) Knowing the actions, strengths and weaknesses of competitors.
- (d) All of the above

### **1.5 Summary**

Economic development of a nation is never an accident. It is always brought about design, i.e., it takes place because of innovation, planning and effort put in by the entrepreneurs. Entrepreneur buys factor services at certain prices with a view to sell their products at uncertain prices in the future. These are action oriented, highly motivated individuals who take risks to achieve goals. Entrepreneurship is the purposeful activity of an individual or a group of associated individuals, undertaken to initiate maintain or aggrandize profit by production, or distribution of economic goods and services. An entrepreneur is a job-giver and not a job-seeker.

The entrepreneur differs from the professional manager in that he undertakes a venture for his personal gratification. Entrepreneurs can be classified into innovative, imitative, fabian and drone. The innovating entrepreneur is one who assembles and synthesizes information and introduces novel combinations of factors. The imitative entrepreneur is adoptive entrepreneur who simply adopts successful innovations introduced by other innovators. The fabian entrepreneurs is timid and cautious. He will imitate other innovations only if he is certain that failure to do so may damage his business. Drone entrepreneur are those whose entrepreneurial activity may be restricted to just one or two innovations. He refuses to adopt changes in production even at the risk of reduced returns.

Thus, entrepreneurs are the pioneers who are instrumental in the economic development, growth and prosperity of a country in the forms of capital formation, improvement in per capita income, improvement in living standards, economic independence, backward and forward linkages, generation of employment, harnessing locally available resources and entrepreneurship, balanced regional growth, reducing unrest and social tension amongst youth, innovations in enterprises.



## 1.6 Keywords

- **Entrepreneur:** Entrepreneur is an organizer who combines various factors of production to produce a socially viable product.
- **Entrepreneurship:** Entrepreneurship means what an entrepreneur does i.e, the art of innovating, initiative, risk taking and implementing.
- **Drone Entrepreneurs:** These entrepreneurs are those who are not inclined to bring changes in their production system as demanded by the change in consumer preferences.
- **Innovative Entrepreneurs:** They are characterized by effective assemblage of information and the analysis of results originated from different set of combinations.
- **Economic Development:** Growth of a country in the way of GDP, per capita income etc.
- **Balanced Growth:** Growth of all sectors and areas equally of an economy during a time period.
- **Infrastructure:** The basic physical and organizational structures and facilities (e.g. buildings, roads, and power supplies) needed for the operation of a society or enterprise.
- **Incentives:** An incentive is anything that motivates a person to do something. For example monetary and non-monetary.
- **Subsidies:** *A subsidy is a benefit given by the government to groups or individuals, usually in the form of a cash payment or tax reduction.*

## 1.7 Self-Assessment Test

- “Entrepreneur is a doer not a dreamer”. Explain the characteristics of an entrepreneur in the light of this statement.
- Distinguish between entrepreneurs and managers.
- Define entrepreneurship. Explain the types of entrepreneur.
- “Entrepreneurship is a process of giving birth to an enterprise”. Discuss.
- In the Indian context, explain the role that entrepreneurship has played in the economic development of the country.

## 1.8 Answers to check your progress

- 1(c), 2 (d), 3(d), 4 (a), 5(b), 6 (d)



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<b>FACTORS AFFECTING ENTREPRENEURSHIP GROWTH: ECONOMIC, SOCIAL, PSYCHOLOGICAL AND POLITICAL FACTORS</b>	

## Structure

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## 2.0 Learning Objectives



After going through the present lesson, you will be able to

- Identify the factors contributing to the development of entrepreneurship on the basis of various researches.
- Discuss the economic factors affecting entrepreneurship development.
- Enlist various social factors contributing towards entrepreneurship development.
- Identify psychological factors affecting entrepreneurship development.
- Describe the importance of political factors in entrepreneurship development.

## **2.1 Introduction**

Is the entrepreneur who we have been acquainted with, in the first lesson, a machine that calculates the probabilities of profits? Not at all. He, like every one of us is very much a part of the society. Therefore, the motivation, the modes of conduct, and the effectiveness of entrepreneurs need to be understood with reference to the general environment in which we live. What does the term ‘environment’ mean? In any society, the environment includes the economic, social, psychological and political aspect of life. In other words, it is true that an economic activity expansion depends on certain environmental forces that promote or retard the entrepreneurial thinking, behavior and efforts. In this lesson, we are going to look at such factors that tend to influence entrepreneurship.

The countries of the world are experiencing an unprecedented burst of inventions. Even the underdeveloped countries are making conscious efforts in encouraging research and development. While the developed countries have the record of commercializing the inventions to their fullest advantage, the less developed ones find their innovations either lying idle or flowing out to the more prosperous nations. The proverbial “brain-drain” that is affecting countries, like India, is due to absence of the necessary infrastructure to capitalize on the numerous inventions that are taking place. The secret of the success of most developed countries is the presence of a large number of dynamic entrepreneurs who provide the fillip for newer and better inventions. The less developed countries, on the other hand, are confronted by a situation where the entrepreneurs just do not seem to come and the existing tend to leave their countries in search of better opportunities. The economically backward nations are characterized by the scarcity of entrepreneurship. Several inimical factors are affecting the growth of this important factor of production.



Some societies – notably in the United States, South Korea and many South East Asian Countries like Thailand and Singapore- are bound with entrepreneurs. Others like China and India have fewer entrepreneurs, although these countries recently changed their laws to encourage entrepreneurship. Countries like England, where many companies such as airlines and automobile manufactures used to be operated by the Government, have in recent times turned these firms to the private sector, encouraging entrepreneurship through, new opportunities in private ownership. Other nations, such as Japan, though are bound by strong traditions; have in recent times started favoring entrepreneurship. From above, it can be said that economic and non-economic factors can affect the level of entrepreneurship within any society.

## 2.2 Empirical Results on Factors Contributing to Entrepreneurship Development

The emergence and development of entrepreneurship is not a spontaneous one but a dependent phenomenon of economic, social, political, psychological factors often nomenclature as supporting conditions to entrepreneurship development. These conditions may have both positive and negative influences on the emergence of entrepreneurship. Positive influences constitute facilitative and conducive conditions for the emergence of entrepreneurship, whereas negative influences create inhibiting milieu to the emergence of entrepreneurship.

Various researchers world over have identified the factors that contribute to the development of entrepreneurship as are summarized below:

Researcher	Factors
Schumpeter	Suitable environment, Institution in grasping the essential facts.
Weber	Protestant Ethics which emerged from the religious belief system of calvinistic puritansim and which is absent in oriental religious belief system.
Levine	Status mobility system where status is attained through outstanding performance, initiative industriousness, and foresight through self reliance and achievement training.
Hagen	Creative personality. High need achievement need order and need autonomy.



	Fairly widespread, creative problem solving ability and a tendency to use it. Positive attitudes towards manual and technical labor and the physical world.
<b>Cochran</b>	Attitude towards occupation, the role expectations held by sanctioning groups and the operational requirements of the job.
<b>McClelland</b>	Need for achievement through self-study, goal setting and inter-personal support. Keen interest in situations involving moderate risk, desire for taking personal responsibility, concentrate measures of task performance, anticipation of future possibilities, organizational skills, energetic and/or novel instrumental activity.
<b>Kilby</b>	Perception of market opportunities, gaining command over scarce resources, and marketing of products. Dealing with public, bureaucratic concessions, licenses, taxes, management of human relations within the firm and with customers and suppliers. Financial and production management technical knowledge (Kilby gives, low priority to need for achievement and moderate risk taking?
<b>Christopher</b>	High demand for product and experience in the lines of business/industry.
<b>Kunkel</b>	Values, attitudes and personality are meaningless variables leading to blind alleys of theory and action.
<b>Nafziger</b>	Perceived challenge to status, migrants, new religious sects and reformed groups.
<b>Staley &amp; Morse</b>	Quality of services in industrial advice, managerial training and industrial research.
<b>Fox, Mines &amp; Papanek</b>	Economic opportunities and political conditions.
<b>Nandy</b>	Supportive community, self-image which gives meaning, value and status to an entrepreneurial career.

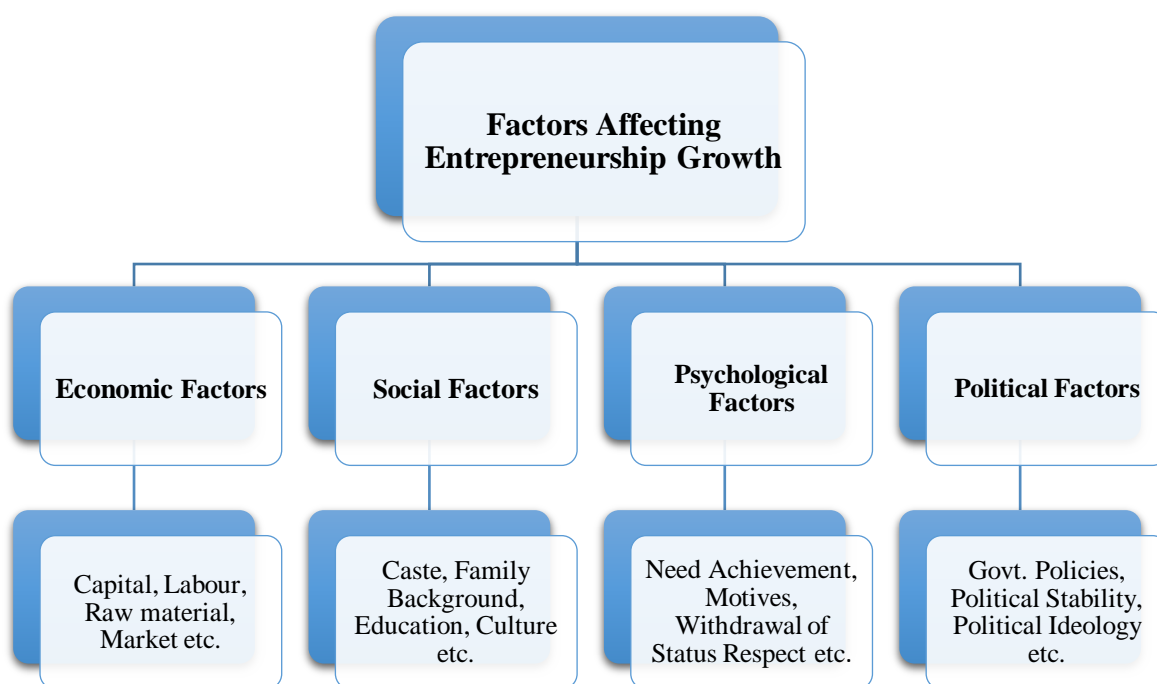


<b>Singer</b>	Traditional system of occupational culture which facilitates the process of modernization, special opportunities, motivation, experience, training or knowledge. Traditional belief and value system which are flexible to allow for reinterpretation with changing conditions.
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Economists agree that the lack of entrepreneurs is not caused by economic conditions alone as was the earlier feeling. It is also due to the whole set of socio-cultural and institutional environment prevailing in the less developed countries.

## 2.3 Factors Affecting Entrepreneurship Growth

Various factors influencing the entrepreneurship growth are as follows:



### 2.3.1 Economic Factors

Economic environment exercises the most direct and immediate influence on entrepreneurship. The economic factors that affect the growth of entrepreneurship are the following:





- **Capital**-Capital is one of the most important prerequisites to establish an enterprise. Availability of capital facilitates for the entrepreneur to bring together the land of one, machine of another and raw material of yet another to combine them to produce goods. Capital is therefore, regarded as lubricant to the process of production. Our accumulated experience suggests that with an increase in capital investment, capital-output ratio also tends to increase. This results in increase in profit which ultimately goes to capital formation. This suggests that as capital supply increases, entrepreneurship also increases. France and Russia exemplify how the lack of capital for industrial pursuits impeded the process of entrepreneurship and an adequate supply of capital promoted it.
- **Labour**-The quality rather quantity of labour is another factor which influences the emergence of entrepreneurship. Most less developed countries are labour rich nations owing to a dense and even increasing population. But entrepreneurship is encouraged if there is a mobile and flexible labour force. And, the potential advantages of low-cost labour are regulated by the deleterious effects of labour immobility. The considerations of economic and emotional security inhibit labour mobility. Entrepreneurs, therefore, often find difficulty to secure sufficient labour. They are forced to make elaborate and costly, arrangements to recruit the necessary labour. The problem of low-cost immobile labour can be circumvented by plunging ahead with capital-intensive technologies, as Germany did. It can be dealt by utilizing labour-intensive methods like Japan. By contrast, the disadvantage of high-cost labour can be modified by introduction of labour-saving innovations as was done in US. Thus, it appears that labour problems can be solved more easily than capital can be created.
- **Raw Materials**-The necessity of raw materials hardly needs any emphasis for establishing any industrial activity and its influence in the emergence of entrepreneurship. In the absence of raw materials, neither any enterprise can be established nor can an entrepreneur be emerged. Of course, in some cases, technological innovations can compensate for raw material inadequacies. The Japanese case, for example, witnesses that lack of raw material clearly does not prevent entrepreneurship from emerging but influenced the direction of entrepreneurship. In fact, the supply of raw materials is not influenced by themselves but becomes influential depending upon other opportunity conditions. The more favorable these conditions are, the more likely is the raw material to have its influence of entrepreneurial emergence.



- **Market**-The fact remains that the potential of the market constitutes the major determinant of probable rewards from entrepreneurial function. Frankly speaking, if the proof of pudding lies in eating, the proof of all production lies in consumption, i.e., marketing. The size and composition of market both influence entrepreneurship in their own ways. Practically, monopoly in a particular product in a market becomes more influential for entrepreneurship than a competitive market. However, the disadvantage of a competitive market can be cancelled to some extent by improvement in transportation system facilitating the movement of raw material and finished goods, and increasing the demand for producer goods. D.S. Landes holds the opinion that improvement in transportation is more beneficial to heavy industry than to light industry because of their effects on the movement of raw materials. Paul H. Wilken claims that instances of sudden rather than gradual improvement in market potential provide the clearest evidence of the influence of this factor. He refers to Germany and Japan as the prime examples where 'rapid improvement in- market was followed by rapid entrepreneurial appearance. Thus, it appears that whether or not the market is expanding and the rate at which it is expanding are the most significant characteristics of the market for entrepreneurial emergence.
- **Infrastructure**-Expansion of entrepreneurship presupposes properly developed communication and transportation facilities. It not only helps to enlarge the market, but expand the horizons of business too. Take for instance, the establishment of post and telegraph system and construction of roads and highways in India. It helped considerable entrepreneurial activities which took place in the 1850s. Apart from the above factors, institutions like trade/ business associations, business schools, libraries, etc. also make valuable contribution towards promoting and sustaining entrepreneurship in the economy. You can gather all the information you want from these bodies. They also act as a forum for communication and joint action. Of late, the importance of business and industry associations has increased tremendously. In the fast changing world of business, entrepreneurs have to move-collectively in order to be more effective and more efficient. They need to constantly check and influence the Government's thinking and decision-making.

### 2.3.2 Social Factors



Social factors can go a long way in encouraging entrepreneurship. In fact it was the highly helpful society that made the industrial revolution a glorious success in Europe. The main components of social environment are as follows:

- **Caste Factor**-There are certain cultural practices and values in every society which influence the actions of individuals. These practices and value have evolved over hundreds of years. For instance, consider the caste system (the varna system) among the Hindus in India. It has divided the population on the basis of caste into four divisions. The Brahmana (priest), the Kshatriya (warrior), the Vaishya (trade) and the Shudra (artisan): It has also defined limits to the social mobility of individuals. By social mobility' we mean the freedom to move from one caste to another. The caste system does not permit an individual who is born a Shridra to move to a higher caste. Thus, commercial activities were the monopoly of the Vaishyas. Members of the three other Hindu Varnas did not become interested in trade and commerce, even when India had extensive commercial inter-relations with many foreign countries. Dominance of certain ethnical groups in entrepreneurship is a global phenomenon. The protestant ethics in the west, the Sammurai in Japan, the trading classes in US and the family business' concerns of France have distinguished themselves as entrepreneurs.
- **Family background**-This factor includes size of family, type of family and economic status of family. In a study by Hadimani, it has been revealed that Zamindar family helped to gain access to political power and exhibit higher level of entrepreneurship. Background of a family in manufacturing provided a source of industrial entrepreneurship. Occupational and social status of the family influenced mobility. There are certain circumstances where very few people would have to be venturesome. For example in a society where the joint family system is in vogue, those members of joint family who gain wealth by their hard work denied the opportunity to enjoy the fruits of their labour because they have to share their wealth with the other members of the family.
- **Education**-Education enables one to understand the outside world and equips him with the basic knowledge and skills to deal with day-to-day problems. In any society, the system of education has a significant role to play in inculcating entrepreneurial values. In India, the system of education prior to the 20th century was based on religion.

In this rigid system, critical and questioning attitudes towards society were discouraged. The caste system and the resultant occupational structure were reinforced by such education. It promoted the



idea that business is not a respectable occupation. Later, when the British came to our country, they introduced an education system, just to produce clerks and accountants for the East India Company, The base of such a system, as you can well see, is very anti-entrepreneurial. The unfortunate result of it is that young men and women in our country have developed a taste only for service. Their talents and capabilities have not been made much use of. Rather it has been wasted in performing routine conventional jobs. Our educational methods have not changed much even today. The emphasis is till on preparing students for standard jobs, rather than marking them capable enough to stand on their feet.

- **Attitude of the Society**-A related aspect to these is the attitude of the society towards entrepreneurship. Certain societies encourage innovations and novelties, and thus approve entrepreneurs' actions and rewards like profits. Certain others do not tolerate changes and in such circumstances, entrepreneurship cannot take root and grow. Similarly, some societies have an inherent dislike for any money-making activity. It is said, that in Russia, in the nineteenth century, the upper classes did not like entrepreneurs. For them, cultivating the land meant a good life. They believed that land belongs to God and the produce of the land was nothing but god's blessing. Russian folk-tales, proverbs and songs during this period carried the message that making wealth through business was not right.

**Can you think of such examples from your own community or any other that you know of? If you can, write a few lines here.**

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- **Cultural Value**-Motives impel men to action. Entrepreneurial growth requires proper motives like profit-making, acquisition of prestige and attainment of social status. Ambitious and talented men would take risks and innovate if these motives are strong. The strength of these motives depends upon the culture of the society. If the culture is economically or monetarily oriented, entrepreneurship would be applauded and praised; wealth accumulation as a way of life would be appreciated. In the less developed countries, people are not economically motivated. Monetary incentives have relatively less attraction. People have ample opportunities of attaining social distinction by non-economic pursuits. Men with organizational abilities are, therefore, not dragged



into business. They use their talents for non-economic ends. The absence of proper economic motives is a general characteristic of agrarian societies in which people do not attach great value to business talents, industrial leadership etc.

### 2.3.3 Psychological Factors

Many entrepreneurial theorists have propounded theories of entrepreneurship that concentrate especially upon psychological factors. These are as follows:

- **Need Achievement**-The most important psychological theories of entrepreneurship was put forward in the early) 1960s by David McClelland. According to McClelland ‘need achievement’ is social motive to excel that tends to characterize successful entrepreneurs, especially when reinforced by cultural factors. He found that certain kinds of people, especially those who became entrepreneurs, had this characteristic. Moreover, some societies tend to reproduce a larger percentage of people with high ‘need achievement’ than other societies. McClelland attributed this to sociological factors. Differences among societies and individuals accounted for ‘need achievement’ being greater in some societies and less in certain others. Analyzing this phenomenon, Paul Wilken has said, “entrepreneurship becomes the link between need achievement and economic growth”, the latter being a specifically social factor. The theory states that people with high need-achievement are distinctive in several ways. They like to take risks and these risks stimulate them to greater effort. The theory identifies the factors that produce such people. Initially McClelland attributed the role of parents, specially the mother, in mustering her son or daughter to be masterful and self-reliant. Later he put less emphasis on the parent-child relationship and gave more importance to social and cultural factors. He concluded that the ‘need achievement’ is conditioned more by social and cultural reinforcement rather than by parental influence and such related factors.
- **Withdrawal of Status Respect**-There is several other researchers who have tried to understand the psychological roots of entrepreneurship. One such individual is Everett Hagen who stresses the-psychological consequences of social change. Hagen says, at some point many social groups experience a radical loss of status. Hagen attributed the withdrawal of status respect of a group to the genesis of entrepreneurship. Giving a brief sketch of history of Japan, he concludes that it developed sooner than any non-western society except Russia due to two historical differences.



First, Japan had been free from colonial disruption and secondly, the repeated long continued withdrawal of expected status from important groups (smaurai) in its society drove them to retreatism which caused them to emerge alienated from traditional values with increased creativity. This very fact led them to the technological progress through entrepreneurial roles.

Hage believes that the initial conditions leading to eventual entrepreneurial behavior is the loss of status by a group. He postulates that four types of events can produce status withdrawal:

- The group may be displaced by force;
- It may have its valued symbols denigrated;
- It may drift into a situation of status inconsistency; and
- It may not be accepted the expected status on migration in a new society.

He further postulates that withdrawal of status respect would give rise to four possible reactions and create four difference personality types:

- **Retreatist:** He who continues to work in a society but remains different to his work and position;
- **Ritualist:** He who adopts a kind of defensive behavior and acts in the way accepted and approved in his society but no hopes of improving his position;
- **Reformist:** He is a person who foments a rebellion and attempts to establish a new society; and
- **Innovator:** He is a creative individual and is likely to be an entrepreneur.

Hagen maintains that once status withdrawal has occurred, the sequences of change in personality formation are set in motion. He refers that status withdrawal takes a long period of time - as much as five or more generations - to result in the emergence of entrepreneurship.

- **Motives-**Other psychological theories of entrepreneurship stress the motives or goals of the entrepreneur. Cole is of the opinion that besides wealth, entrepreneurs seek power, prestige, security and service to society. Stepanek points particularly to non-monetary aspects such as independence, persons' self-esteem, power and regard of the society.

On the same subject, Evans distinguishes motive by three kinds of entrepreneurs:

- Managing entrepreneurs whose chief motive is security.



- Innovating entrepreneurs, who are interested only in excitement.
- Controlling entrepreneurs, who above all other motives, want power and authority.

Finally, Rostow has examined inter-generational changes in the families of entrepreneurs. He believes that the first generation seeks wealth, the second prestige and the third art and beauty.

- **Others**-Thomas Begley and David P. Boyd studied in detail the psychological roots of entrepreneurship in the mid 1980s. They came to the conclusion that entrepreneurial attitudes based on psychological considerations have five dimensions:
  - First one is 'need-achievement' as described by McClelland. In all studies of successful entrepreneurs a high achievement-orientation is invariably present.
  - The second dimension that Begley and Boyd call 'locus of control' This means that the entrepreneur follows the idea that he can control his own life and is not influenced by factors like luck, fate and so on. Need-achievement logically implies that people can control their own lives and are not influenced by external forces.
  - The third dimension is the willingness to take risks. These two researchers have come to the conclusion that entrepreneurs who take moderate risks earn higher returns on their assets than those who take no risks at all or who take extravagant risks.
  - Tolerance is the next dimension of this study. Very few decisions are made with complete information. So all business executives must have a certain amount of tolerance for ambiguity.
  - Finally, here is what psychologists call 'Type A' behavior. This is nothing but "a chronic, incessant struggle to achieve more and more in less and less of time". Entrepreneurs are characterized by the presence of 'Type A' behavior in all their endeavors.

#### 2.3.4 Political Factors

A football player might possess exceptional talent. But, his contribution to the nation and the world of sports would remain negligible, if his performance is restricted to the courtyard of his own house. He needs a football ground to practice on and resources to buy the accessories. He also requires encouragement and support from those in authority so that he could freely play with others and prove his talent. In the same way, an entrepreneur, however creative he/she may be, cannot function without



the supportive actions of the Government. It is for the government/society to ensure the availability of required resources for the entrepreneurs and also the accessibility to them. This is because the successful entrepreneur contributes to the well being of the society. Policies relating to various-economic aspects like prices, availability of capital, labor and other inputs, demand structure, taxation, income distribution, etc. affect growth of entrepreneurship to a large extent. Primitive government activities such as incentives and subsidies contribute substantially to entrepreneurial performance. At the same time, Government policies like licenses, regulations, favoritism, government monopolies, etc. are undesirable for the growth of business enterprises. Above all, a Government that is politically stable and united can affect entrepreneurial activities in a significant manner.

**Is there a business entrepreneur in your neighborhood? Try to gather information on his/her views on various government policies, for example, on taxation, finance, labor etc. Also ask him/her about the opportunities and growth prospects of a business unit. Write down your observations.**

**My observations are:**

India, all the above mentioned environmental forces have turned in favor of enterprising men and women. There is a visible change for the better in the highly inactive entrepreneurial field in the country. The tight grip of religious and traditional, ideas and practices have begun to loosen. Dogmas (settled opinions) and superstitions have lost the hold they earlier had. It is encouraging the 'non-commercial' classes to consider economic opportunities more sympathetically. As a result, occupational division based on caste system has undergone tremendous traditional activities, social approval etc. have become less important. More important now, are the economic factors such as access to capital and possession of entrepreneurial attitudes and business knowledge.

Development of infrastructure, changes in government policies in favor of business and industry and of course, rise in demand for products manufactured are some of the other factors that have led the Indian entrepreneurs to look for new business opportunities.





## 2.4 Check Your Progress

1. Which one of the following includes in political factors?
  - a) Political Ideology
  - b) Govt. policies
  - c) Political Stability
  - d) All of the above
2. Need Achievement theory was given by.....?
  - a) Hage
  - b) David McClelland
  - c) David P. Boyd
  - d) Rostow
3. Factor contributed by Fox, Mines & Papanek was...?
  - a) Technology and Innovation
  - b) Suitable environment, Institution in grasping the essential facts
  - c) Economic opportunities and political conditions.
  - d) All of the above
4. Who one of the followings is not included in economic factors?
  - a) Market
  - b) Raw material
  - c) Infrastructure
  - d) Culture
5. Factor contributed by Schumpeter was...?
  - a) Suitable environment, Institution in grasping the essential facts.
  - b) Creative Personality
  - c) Both of the above
  - d) None of the above



6. Which one of the followings is included in Social factors?

- a) Education
- b) Caste
- c) Family Background
- d) All of the above

## 2.5 Summary

The countries of the world are experiencing an unprecedented burst of inventions. Even the underdeveloped countries are making conscious efforts in encouraging research and development. While the developed countries have the record of commercializing the inventions to their fullest advantage, the less developed ones find their innovations either lying idle or flowing out to the more prosperous nations. The proverbial “brain-drain” that is affecting countries, like India, is due to absence of the necessary infrastructure to capitalize on the numerous inventions that are taking place.

Entrepreneurship does not emerge at its own. Various economic, social, political and psychological factors are responsible for the emergence and growth of entrepreneurship. These exert both positive and negative impact on entrepreneurship. Positive impact refers to existence of various factors facilitating growth and negative impact refers to those factors adversely affecting the emergence and growth of entrepreneurship. The process of interaction and adaption between an individual and the environment is ever going on process. At any given moment of time, the individuals take meanings from the situations in which they find themselves through the media of social rules, group norms and cultures, past experiences and future expectations.

## 2.6 Keywords

- **Culture:** It includes the customs, ideas, and beliefs etc. of a particular section of country or society.
- **Entrepreneurship:** Entrepreneurship means what an entrepreneur does i.e, the art of innovating, initiative, risk taking and implementing.
- **Economic Development:** Growth of a country in the way of GDP, per capita income etc.



- **Infrastructure:** The basic physical and organizational structures and facilities (e.g. buildings, roads, and power supplies) needed for the operation of a society or enterprise.
- **Economic Factors:** It comprises of capital, labour, raw material and market demand.
- **Need Achievement:** It is social motive to excel that tends to characterize successful entrepreneurs especially when reinforced by cultural factors.
- **Retreatist:** He who continues to work in a society but remains different to his work and position.
- **Capital:** The amount of money that is important factor to start a new business.
- **Values:** The values are the belief that shape individual and group attitudes.
- **Political Instability:** It defined as the frequent and sudden changes in the leadership, policies or in conditions of a country.
- **Political Ideology:** It includes some specific ethics, principles, doctrines of the ruling party in any country.

## 2.7 Self-Assessment Test

1. Discuss the environmental factors which influence entrepreneurship.
2. What are the important economic factors affecting entrepreneurial growth? Discuss.
3. What are the inimical factors that are retarding the growth of entrepreneurs in the less developed countries? Explain.
4. Write short notes on the followings:
  - Political factors
  - Economic factors
  - Social factors
  - Psychological factors

## 2.8 Answers to check your progress

- 1(d), 2 (b), 3(c), 4 (d), 5(a), 6 (d)

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<b>ENTREPRENEURSHIP DEVELOPMENT</b>	

## Structure

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## 3.0 Learning Objectives

After reading this lesson, you will be able to:



- Define competency.
- Understand the qualities of a successful entrepreneur.
- Explain the procedure to develop and sharpen the entrepreneurial competencies.

### **3.1 Introduction**

Owning an enterprise is a great dream for those who look jealous at people who have made it from nothing to vast riches. It often remains just a dream for some, but some others can turn the, dream into action. Many ventures do not fetch returns more than subsistence wages that too after a lot of hard work and worry. It is often that the person trapped in such a business turns out to be a dreamer than a pragmatist, “when he/she gets into the venture. A small business venture can be a boon provided one gets into it by the right way, and knows what to expect and do; otherwise it can be a dreadful nightmare. Few know exactly what they want and why and how they will do it. Some do not dream of riches, but of an interesting and fulfilling life style, which often translates into self-employment in trade or profession, or turning a recreational hobby, into a business. More often, the one who has made a good business out of a hobby had never entered the venture with dreams of riches. Vast riches are for the few, but it is probable to plan and look forward to self-employment where you can earn better than a living wage. On the other hand, there is little reason to stay self-employed if you can work for someone else at better wages than your own venture returns.

### **3.2 Meaning of Competency**

When we see entrepreneurs, we find that some turn their business successfully called ‘successful entrepreneurs’ while others do not. Then, a question arises what makes the entrepreneurs successful. In other words, what are the qualities or characteristics of the successful entrepreneurs? The possession of certain knowledge, skill or personality profile called ‘entrepreneurial competencies’ or ‘traits’ help the entrepreneurs perform well.

In simple terms, a competence is an underlying characteristic of a person which leads to his/her effective or superior performance in a job. A job competence is a good combination of one’s underlying characteristics such as ‘one’s knowledge, skill, motive, etc. which one uses to perform a given job well. It is important to mention that the existence of these underlying characteristics may or may not be,



known to the person concern. This implies that the underlying characteristics may be unconscious aspects of the person. The underlying characteristics possessed by an entrepreneur which result in superior performance are called the 'entrepreneurial competencies' or 'traits'.

In order to understand more and better about entrepreneurial competencies, let us first understand its components, i.e., knowledge, skill and motive. These are explained one by one as follows:

- **Knowledge**-In simple terms, knowledge means collection and retention of information in one's mind. Knowledge is necessary for performing a task but not sufficient. For example, a person having the knowledge of cricket playing could be in a position to describe how to play. But, mere description will not enable the listener to play cricket unless something more than knowledge is there. We see in real life that people possessing mere knowledge have miserably failed while actually performing the task. What this implies is that one also needs to have skills to translate the knowledge into action/practice.
- **Skill**-Skill is the ability to demonstrate a system and sequence of behaviour which results in something observable, something that one can see. A person with playing ability, i.e., skill can properly identify the sequence of action to be performed to win the cricket match. Remember, while knowledge of playing cricket could be acquired by reading, talking or so on, skill to actually play cricket can be acquired by practice i.e., playing on a number of occasions. This means both knowledge and skill are required to perform a task.
- **Motive**-In simple terms, motive is an urge to achieve one's goal what McClelland terms 'Achievement Motivation'. This continuous concern of goal achievement directs a person to perform better and better. Coming back to the, same example of cricket playing, one's urge to become the best player helps him constantly practice, playing to look out for ways and means to improve his play.

Thus, in order to perform any task effectively and successfully including establishing and running an industrial unit, a person (entrepreneur) needs to possess a set of knowledge, skill and motive which could be together labeled as 'competencies' or 'traits'.

### 3.3 Entrepreneurial Competencies



The true entrepreneur is one who is endowed with more than average capacities in the task of organizing and coordinating the various other factors of production. He should be a pioneer, a captain of industry. The supply of such entrepreneurship is however quite limited and all are not endowed with such talent. The modern entrepreneur is one who detects and evaluates a new situation in his environment and directs the making of such adjustments in the economic systems as he deems necessary. He conceives a new industrial enterprise, displays considerable initiative, grit and determination in bringing his project to fruition.

Some people believe that entrepreneurs are born not made. In other words, business family background is essential to the success for entrepreneurs. Other people believe that entrepreneurs are made not born. According to some people, person with proper knowledge and skills acquired through education and experience can become successful entrepreneurs.

In view of above controversy in order to understand clearly what it takes to be a successful entrepreneur, research institutions and behavioral scientists, through their research studies, have tried to resolve the controversy on what makes a successful entrepreneur. The findings of the institutional and research studies on entrepreneurial competencies are as follows:

### **3.3.1 Entrepreneurship Development Institute of India's Study**

Entrepreneurship Development Institute of India, Ahmedabad conducted a research study to identify what makes an entrepreneur successful. The study was conducted under the guidance of Prof. David C. McClelland, a well known behavioral scientist in three countries namely India, Malawi and Equodor. The outcome of the study has been identification of a set of entrepreneurial competencies or characteristics that result in superior performance. The major finding of the study was that the possession of competencies is necessary for superior performance. Following is the list of major competencies identified by the study that lead to superior performance of the entrepreneurs:

- Initiative.
- Looking for opportunities.
- Persistence.
- Information Seeker.
- Quality Conscious.





- Committed to work.
- Efficiency seeker.
- Proper planning.
- Problem Solver.
- Self-confidence.
- Assertive.
- Persuasive.
- Efficient monitor.
- Employees' well-wisher.
- Effective strategist.

### 3.3.2 Individual Research Studies

Several individual scholars have also undertaken research studies to identify the entrepreneurial competencies or the quality of a successful entrepreneur. The findings of some of the studies are as follows:

In his study of entrepreneurial development of Madras city of India, James J. Bema listed the following competencies:

- He is an enterprising individual, energetic, resourceful, alert to new opportunities, able to adjust to changing conditions and willing to assume risks involved in change.
- He is interested in advancing technologically and in improving the quality of his product.
- He is interested in expanding the scale of his operations, and he reinvests earnings to this end.
- James T. McCrory opines that successful entrepreneur possesses the following qualities:
- He lives frugally and saves for the development of his enterprise. He is skilled enough, quality conscious and very quick to learn from others.
- He is also very versatile and resourceful with the limited resource at his command. He is very sensitive to new demands and market changes.
- He is tenacious to an extreme as and when any industrial opportunity causes challenge for him.
- B.C. Tandon has listed the four major qualities of a successful entrepreneur:
- A successful entrepreneur should have capacity to bear risk involved in the business.



- He should possess the required technical knowledge and should be ready to adapt to change, as and when needed.
- The entrepreneur should also have ability to marshal the resources at his command in the best possible manner for achieving his ultimate business objectives.
- An entrepreneur should also have ability to organize and manage the various factors of production to the best of his enterprise. For this, he requires high and relevant knowledge of management theory.

Robert D. Hisrich has identified a few more entrepreneurial traits. In his opinion the entrepreneur must have adequate commitment, motivation and skill to start and build a business. It is his responsibility to determine if the management team has the complementary skills necessary to succeed. He feels that the entrepreneur must possess the following traits in addition to those mentioned in the preceding pages:

- **Motivation:** An entrepreneur must build an efficient team, keep it motivated and provide an environment for individual growth and career development.
- **Self-confidence:** Entrepreneurs must have the mental capacity to face any situation. They should also have the ability to inspire others. They must have the confidence in themselves and the determination to achieve their goals.
- **Long-term Involvement:** Entrepreneurs must be committed to long-term projects which required continuous and consistent involvement.
- **High Energy Level:** Success of an entrepreneur demands the ability to work long hours for sustained periods of time.
- **Trouble-shooter:** The entrepreneur must possess the trait of the proverbial “trouble-shooter”. He must have the ability to identify where a problem is and suggest on the spot solutions.
- **Initiative:** The entrepreneur must have initiative, accepting personal responsibility for actions and above all make good use of resources. It is this trait which gives the entrepreneur the courage to take risks and learn from failures.
- **Goal-setter:** An entrepreneur must be able to set challenging, but realistic goals. This personal trait can go a long way in the all round progress of a nation.



These personal traits make an entrepreneur a successful person. However, it must be stated that no entrepreneur possess all these strengths. No entrepreneur is born with all these traits. It is possible for him to acquire these traits if the environment is suitable for this purpose.

While one can add certain other factor to the list of entrepreneurial competencies, the said competencies appear to be major one: An integrated view of the qualities of a successful entrepreneur can be listed as follows:

- **Initiative:** When can we say that a person has initiative? When he/she takes action that goes beyond job requirement or the demands of the situation? When he/she does things before being asked or forced to by circumstance, and acts to extend the business into new areas, products or services. Most of the successful entrepreneurs show this competency in some form or the other. They, on their own take decisions to launch their enterprise or expand and grow.

Nikhil was standing near the sea wall at Marine Drive in Bombay along with a number of people: A boy who had bent too much on top of the wall fell in the water and started drowning. People shouted but did not do anything else. Nikhil jumped into the sea swam out and saved the boy. Nikhil took the initiative which brought out some hidden skills in him.

Rasiklal Zaveri was a successful businessman trading/dealing in spices. He was rich and well established. But he felt that this was not enough. He decided to produce some mixtures of the spices by processing them and set up a unit grinding processing and packaging these. He did this although it was not required and he succeeded.

- **Seeing and acting on opportunities:** Look for and takes action on opportunities. When a person sees and acts, on opportunities, either business or personal growth or seizes unusual opportunities to obtain finance, equipment, land, work space or assistance.

There is a case of a film distributor in Jamshedpur, Mr. Nair. The story of how he became a distributor is interesting. He was working for TISCO at Jamshedpur. One day, he met the Secretary of one 'United Club' in the town, who asked him whether he could help him in getting a movie to show in his club as he had difficulties in procuring it. Nair agreed and went to Calcutta to get the movie.



There he met an acquaintance who was connected with the film line; on being asked Nair told him the reasons for his visit. The acquaintance offered to help him, but Nair refused and still collected name and addresses of some distributors, He then went to a well known firm of distributors, got a movie for Rs.5,000/ and gave it to the club for Rs.7,000/. This started him off and he began supplying movies to that club and other movie theatres in Jamshedpur. Gradually the work increased and he established an office in Calcutta and became a full time distributor.

- **Persistence:** Takes repeated action to overcome obstacles that get in the way of reaching goals. This is a very important competency. As an entrepreneur your path may not be smooth, you might face difficulties, but you have to develop the qualities of a spider and carry on without getting disheartened. And finally success will be yours.

Now you know what persistence is, and what you can learn from the example.

Look at the case of Leela. She decided to set up a unit manufacturing FRP products. She purchased land engaged a firm of contractors for construction of building. As luck would have it the watchman engaged there got murdered (some personal enmity) and the contractor's workers panicked and left the construction work. Somehow she managed to get the construction completed. Much later by the time she could start production FRP technology had changed and she hardly had any orders. As a result she defaulted in payment of interest to the financial institution which had extended financial assistance in initial investment. But did she lose heart? No she sold the land and building paid the financial institution salvaged the machinery shifted it to a rented place and started again.

- **Information seeking:** Takes action on getting information to help reach objectives or clarify problems. A person does research on how to provide a product or services, consults experts for business or technical advice, seeks information for what is needed and uses contacts or information networks to obtain information. When you set out to put up your own enterprise, you will not know everything. You will have to gather information from elsewhere and acquire the knowledge. You will have to take help from experts, refer to books and journals.

Shreyas Gandhi of Gujarat is a successful manufacturer of office equipments mainly inter-communication systems. But as he puts it in electronics one has to be one one's toes all the time as it is a fast changing line. So he has constantly to be on the lookout and search for other products and



gather information about them. And he does that by reading several electronic magazines available in India. These magazines and information on market conditions help him in deciding whether he should go for a change and when. For example: when he found that T.Vs. as a communication line are coming up very fast he planned to manufacture TVs.

So once you have set up your industry and established yourself, do not sit back and relax but be up to date on information about the line of your choice.

- **Concern for high quality of work:** Acts to do things that meet or beat existing standards for excellence. Such persons always have a desire to produce work of high quality and to favourably compare one's own work to that of others. This would help you-not only to stand the competition, create or expand your market, but also give you a sense of satisfaction and achievement.

Take the case of Gopukumar. He is an architect. He started with designing private residences and graduated to designing big hotels and shopping complexes. What has made him successful and popular is the fact that he believes in giving high quality of work and is meticulous about each and every detail of the design. He never compromises on quality and has self-set standards of excellence which has earned him a reputation in the building construction line.

- **Commitment to work contract:** Places the highest priority on getting a job completed. Makes a personal sacrifice or extends extraordinary effort to complete a job. Or accepts full responsibility for problems in completing a job for others and pitches in with workers or works in their places to get the job done and expresses a concern for satisfying the customer. A successful entrepreneur not only provides quality goods and keeps up-to-date information about his product but he/she is also particular about keeping to the delivery-time schedule and satisfying a customer. He/she would go to any lengths to make any required efforts to complete work in time.

Agnes Kottoor is a woman entrepreneur manufacturing optical lenses in Kochi. She employs about a dozen girl workers and has built up a good clientele. Kerala is known for load shedding and power cuts. Agnes also has to suffer due to this. During day time there would be power cuts and so obviously the work would have to stop and as her workers are all girls, they have to be allowed to go home on time. But what about timely delivery to the customers? Agnes is very particular about that. So what does she do? She herself works on the machines, grinding the lenses, sometimes upto 2 a.m. in the morning and finishes the work. That is an example of commitment to work contract.



- **Efficiency orientation:** Finds ways to do things faster or with fewer resources or at a lower cost. Such a person looks for ways to reduce costs and time, uses information on business tools to improve efficiency and expresses concern about costs against benefits of any improvement or change. It is not enough merely to manufacture produce and sell. A successful entrepreneur always thinks of ways in which he/she can improve the product or service, innovate and reduce costs wherever he/she can. That is efficiency orientation.

Shreyas Gandhi of Ahmedabad is a successful trader in intercoms, calculators, refrigerators, vacuum cleaners, air conditioners and other electronic equipment. His planning for inventory and market is good. Shreyas Gandhi deals in approximately forty items, the market requirement for each is different and he wants to ensure that he does not overstock and increase his interest burden. At the same time, he does not want to under stock, in which case he would not be able to satisfy his customers. So, he engaged an institute of management to conduct a survey of the market for his items which would enable him to assess the minimum level of stock he should keep for each item. Certainly, this is an efficient way of productive operations.

- **Systematic planning:** Develops and uses logical step by step plans to reach goals. He/she plans by breaking a large task into sub-tasks, develops plans that anticipate obstacles, evaluates alternatives and most importantly takes a logical and systematic approach to activities. As you know when you setup, or when you are in the process of setting up your venture, if you plan everything systematically and go step by step, half the battle will be won. Not that there would not be any difficulties, but your planning will enable you to deal with them. You can see from the following example that how Mr. Chandy Sam planned step-by-step to reach his goal and achieved it.

For systematic planning one can refer to Chandy Sam of Trivandrum. Chandy lost his father while still in college. Though he was still a student he had a hobby of repairing electrical and mechanical items. Due to his father's demise he had to leave his studies and here his hobby helped him. He started a service chain for repairing refrigerators and air conditioners. But what he really wanted to do was to go into manufacturing. He 'started planning and preparing himself for this. He first tried to find out what equipment he could manufacture which would involve low investment,



less machinery and have a good market in Kerala. He observed and studied various equipment even imported freezers. He read up on the subject, referred technical material. And then made one or two models of freezers based on the imported one. He could sell them at a low price and low profit. He received more orders and needed money for machinery and working capital. Though he could not furnish collateral security, he finally could convince bankers by showing them the few freezers he had already manufactured. The loan was sanctioned. He started production of freezers and innovative voltage stabilizers. Slowly he headed for new products. Today he manufactures refrigerators, water coolers, air conditioners and combination coolers, and has a high turnover.

- **Problem solving:** Identifies new and potentially unique ideas to reach goals. Switches to an alternative strategy to reach a goal, generates new ideas or innovative solutions. Everyone faces problems in life, and more so if you happen to be an entrepreneur. It is important that as an entrepreneur you have to have a problem solving attitude and not a problem avoiding one. Problems are bound to occur during the life of your enterprise, so if you have or develop this competency, life of your enterprise will run smoothly.

George Thomas of Kerala had taken entrepreneurship development training from EDI and was all set to start production in his engineering unit. The building was ready machinery had been installed and raw material stocked. There was however one snag. He had not yet received power connection. Countless visits to and voluminous correspondence with the Electricity Department had not produced any results. The problem was how to procure it. He thought and came up with a solution. He printed cards inviting people for the inauguration of his unit (dated 3 days later) stating that the Chief Minister of the State would be inaugurating it (This with tacit agreement of P. S. to the Chief Minister). He then went and showed the card to the concerned official of the Electricity Department. The next day he got the power connection.

We don't say that you have to resort to such means to solve a problem, but you have to bear in mind that you should be a problem solver - if you already are-not, develop yourself.



- **Self-confidence:** Has a strong belief in self and own abilities. Expresses confidence in own ability to complete a task or meet the challenge. He/she sticks with own judgment in the face of opposition or early lack of success, or does something which he/she finds risky.

If you have self-confidence in yourself and your abilities, you can succeed in whatever you do. When you take up any task and if you have confidence in yourself that you are capable of doing it well, you can accomplish it in a much better fashion. Do we need an example here? Every successful person has self-confidence. You have to believe in yourself.

- **Assertiveness:** Confronts problems and issues with other directly. Confronts problems with others directly, tells others what they have to do and disciplines those failing to perform as expected.

Assertiveness is “not to be confused with aggressiveness. Aggression can be direct or indirect, honest or dishonest - but it always communicates an impression of superiority and disrespect. While assertive behavior is active, direct and honest. It communicates an impression of self-respect and respect for others. This behavior leads to success without retaliation and encourages honest, open relationship.

Let us look at the following three examples of conversation:

1. “Only an idiot would think of a solution like that! Don’t you even think before you talk?”
2. “You know, maybe we might want to think about a different alternative. What do you think?”
3. “I am not completely comfortable with your solution. Will you please develop at least one more option?”

Number one is an example of aggressive behavior, number two of non-assertive behavior, while number three is a good example of assertiveness. It is honest, respectful and invites co-operation.

- **Persuasion:** Successfully persuades others. An entrepreneur is said to be persuasive when he/she can convince someone to buy a product or service to provide financing or to do something that he





would like from the person. He/she asserts own competence or company's qualities or strong confidence in own or company's products or services.

If you, as an entrepreneur, cannot or do not convince others about the viability of your project or product or your own capabilities, how can you make a successful entrepreneur? To possess this competency is therefore very important for you. This competency is also interlinked with 'self-confidence'. If you have self-confidence, only then you can persuade/convince others and get your work done.

Persuasion can be of different types. Jayabharati a women entrepreneur was refused loan by a bank as it felt that her project was not viable and she had no managerial skills. At the end of numerous visits to the Bank Jayabharati could convince the Bank about both and her loan was sanctioned.

Then there is Dinesh Shah a very successful entrepreneur who owns not one but a number of chemical units. His persuasion techniques were different. When set up his first small unit in 1977 the Government declared 100% excise exemption for dyestuff units with a turnover up to 5 lakhs. The duty however was reimposed in 1982. Dinesh organized his co-manufacturers and led a delegation to the then Finance Minister and persuaded a number of small and medium dyestuff manufacturers to close down their units for two months. Production resumed only after the Government relented and offered the concession.

- **Use of influence strategies:** Use of varieties of strategies to influence others. Such an entrepreneur acts to develop business contacts, uses influential people to accomplish his/her own objectives, limits the information given to others and uses strategies to influence others.

Kalindi is entrepreneur who manufactures paper napkins for use in hotels, restaurants and bars. She has customers in all the southern states and is now well established. There was a time before she had set up her unit when she could not get loan from any bank in her home town, Bangalore. But, she did not give up. Fortunately for her she knew the president of the Association of Women Entrepreneurs of Karnataka (AWAKE). The president of AWAKE is a very influential and resourceful person, and could get the loan sanctioned from a scheduled bank. (Here Kalindi used her contact to get her work done).

So, now you know what these competencies are and how important they are for you as potential entrepreneurs.



### 3.3.3 Developing Entrepreneurial Competencies

As mentioned earlier, competency results in superior performance. This is exhibited by one's distinct behavior in different situations. The popular Kakinada experience has proved beyond doubt that the entrepreneurial competency can be injected in human minds through education and training. Competency finds expression in human behaviour. How to develop and sharpen the entrepreneurial competency is suggested in the following method or procedure.

The procedure involves four steps. These are:

- Competency Recognition
  - Self- Assessment
  - Competency Application
  - Feed back
- **Competency Recognition:** Acquisition of a new behavior begins with understanding and recognition of what a particular behavior means. In other words, the first step involved in developing a particular competence is first to understand and recognize a particular competence.
  - **Self-Assessment:** Once the particular competence is understood and recognized, the next step towards acquiring a particular behavior/competence is to see whether one possesses the particular competence or not. If yes, then to see how frequently one exhibits the same in his practical life.
  - Where one stands with respect to a particular competence or what is the level of one's competence can be ascertained by posing and answering relevant questions to a competence.
  - **Competency Application:** Having known where one stands with respect to a particular competency, one needs to practice the same on continuous basis in various activities. In order to make a new behavior a part of one's personality, the particular behavior/competency needs to be applied frequently even in the simplest activities that one performs in one's day-to-day life. This is because "practice makes a man perfect".
  - **Feedback:** After understanding, internalizing and practicing a particular behavior or competence, one needs to make an introspection of the same in order to sharpen and strengthen 'one's competency. This is called 'feedback'. In simple terms, feedback means to know the strengths and weaknesses of one's new behavior. This helps one know how the new behavior has been rewarding.



This enables one to sustain or give up the exhibition of a particular behavior or competence in his future life.

### 3.3.4 Tools of Assessment

Entrepreneurship demands certain traits, skills and qualities. An individual has to have some latent qualities for getting groomed into an entrepreneur. Before venturing to take up self-employment, one has to make a self-assessment of himself/ herself to know whether he/she has the required traits. Apart from this, selection or a screening process is necessary for:

- Financial and industrial assistance agencies to select the right persons for financing.
- Entrepreneur training and development agencies for selecting real potential entrepreneurs to achieve best results.

With the liberal promotional programmes, financial stakes of a new entrepreneur are becoming increasingly smaller. Therefore, tools and techniques are required to identify entrepreneurial qualities and measure their potential to select and encourage the right ones through Entrepreneurship Development Programmes. Many psychological and behavioral tests have been developed and validated both in India and abroad.

At the end of this chapter, Appendix A give self-assessment questionnaire to assess you in respect to, those characteristics which are needed to successfully start and operate a business.

## 3.4 Check Your Progress

1. What does competence means?
  - (a) Underlying characteristic of a person which leads to his/her effective or superior performance in a job
  - (b) It is motivation to do something
  - (c) Both a & b
  - (d) All of the above
2. Kakinada experience has proved that.....?
  - (a) The entrepreneurial competency cannot be injected in human minds through education and training.



- (b) The entrepreneurial competency can be injected in human minds through education and training.
  - (c) Cannot say anything
  - (d) All of the above
3. As per Robert D. Hisrich the traits of the entrepreneurs can be ...?
- (a) Self-confidence.
  - (b) High Energy Level
  - (c) Motivation
  - (d) All of the above
4. Who one of the followings is the component of competence?
- (a) Skill
  - (b) Knowledge
  - (c) Motive
  - (d) All of the above
5. As per Prof. David C. McClelland the competences of the entrepreneurs can be ...?
- (a) Initiative
  - (b) Looking for opportunities
  - (c) Persistence
  - (d) All of the above
6. How to develop and sharpen the entrepreneurial competency?
- (a) Competency Recognition
  - (b) Self- Assessment
  - (c) Competency Application
  - (d) Feed back
  - (e) All of the above

### 3.5 Summary

Entrepreneur is a person who launches his own venture. An entrepreneur does not have specific features. An entrepreneur could be a sensitive person, fat, thin, worrier, creative, competent, leader, social but some key qualities have been identified which ever entrepreneur must possess in order to



succeed. Those qualities are innovation, risk-taking, hard work, goal setting, self-confidence and above all, their burning desire to excel. An entrepreneur is not a package of qualities. Different entrepreneurs exhibit different traits. An entrepreneur performs various types of functions. Growth of his enterprise depends upon the ways he performs various functions like innovation, risk-taking, decision-making, organization and management.

As mentioned earlier, competency results in superior performance. This is exhibited by one's distinct behavior in different situations. The popular Kakinada experience has proved beyond doubt that the entrepreneurial competency can be injected in human minds through education and training. Competency finds expression in human behavior. The entrepreneurial competency can be develop and sharpen through the procedure involves Competency Recognition, Self- Assessment, Competency Application & Feedback.

### 3.6 Keywords

- **Entrepreneur:** An entrepreneur is an individual who creates a new business, bearing most of the risks and enjoying most of the rewards.
- **Competency:** It is an underlying characteristic of a person which leads him to effective or superior performance in his job.
- **Knowledge:** Collection and retention of information in one's mind.
- **Personality:** The combination of characteristics or qualities that form an individual's distinctive character.
- **Skill:** It is the ability to demonstrate a system and sequence of behavior which results in something observable, something that one can see.
- **Leadership:** It is the process of influencing and supporting others to work enthusiastically towards achieving objectives.
- **Human Behavior:** It is the potential and expressed capacity for physical, mental, and social activity during the phases of human life.
- **Persistence:** The fact of continuing in an opinion or course of action in spite of difficulty or opposition.
- **Systematic planning:** Develops and uses logical step by step plans to reach goals.



- **Motive:** Motive is an urge to achieve one's goal

### 3.7 Self-Assessment Test

- What do you understand by entrepreneurial competency? Can they be acquired?
- "Entrepreneurs are made not born". Comment
- Discuss the qualities of a successful entrepreneur.
- Describe the process of developing entrepreneurial competencies.

### 3.8 Answers to check your progress

- 1(a), 2 (b), 3(d), 4 (d), 5(d), 6 (e)

### 3.9 References/ Suggested Readings

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## Appendix A

### Self-Assessment Questionnaire

by **Dr. B. Albert Friedmanm**

This questionnaire is scientifically designed to help you assess yourself in respect to those characteristics which are need to successfully start and operate a business. It will take approximately 30 minutes to complete it, and the entire questionnaire should be completed at one time.



Find a quiet place and start reading each question carefully'. If you can answer "Yes" to the question all the time or most of the time, then put check in the column marked "Yes". If you can answer "No" to the question all the time or most of the time, then put a check in the column marked "No". If you are unsure of which check mark to put down, leave the scoring column blank and go on to the next question.

When you have completed all the questions, review your answers. You can change answers if you like at this time, but once you start to evaluate the entire questionnaire, DO NOT CHANGE ANY ANSWERS.

Good luck and best wishes.

	Yes	No
1. Do you enjoy speaking in front of audiences?	_____	_____
2. In conferences, do you find yourself clarifying what others have said?	_____	_____
3. Did you do well in your written work at school?	_____	_____
4. Can you keep up a conversation even when your partner is not talking much?	_____	_____
5. When you meet a business-person, do you ask a lot of questions about his/her field of work?	_____	_____
6. Do you believe in luck?	_____	_____
7. When you come up with a new idea, do you generally try to "sell" others on it?	_____	_____
8. Do you generally work to high standards?	_____	_____
9. Do you have a long-range financial goal?	_____	_____
10. Have you ever used the "float" in your checking account?	_____	_____
11. Do you attempt to do a job better than is expected of you?	_____	_____



12. When you speak to people, do you make it a point to maintain good eye contact? \_\_\_\_\_
13. Were any of your grandparents in 'business for themselves'? \_\_\_\_\_
14. Do you enjoy telling a joke? \_\_\_\_\_
15. Do some people think you are downright obnoxious? \_\_\_\_\_
16. Was either your father or your mother a migrant from a migrant from a place outside your present place of living? \_\_\_\_\_
17. Are you a good loser? \_\_\_\_\_
18. Have you ever sought the counsel of a professional in personal matters such as marriage, financial or career problems? \_\_\_\_\_
19. Do you normally take a nap when, you get home from work? \_\_\_\_\_
20. In personal relations do you find yourself falling for a goodline? \_\_\_\_\_
21. Do you know how to end conversation tactfully? \_\_\_\_\_
22. Have you ever been in debt "over your head"? \_\_\_\_\_
23. Do people sell you things you don't want? \_\_\_\_\_
24. Do you subscribe to any technical magazines which pertain to your primary field of work? \_\_\_\_\_
25. In your business career so far, have you had the advice and counsel of someone who has "been around"? \_\_\_\_\_
26. Do you generally plan out of action before getting involved with a new venture? \_\_\_\_\_
27. Do you normally work on weekends? \_\_\_\_\_





- |     |  |       |       |
|-----|--|-------|-------|
| 28. | Do you enjoy outdoor sports which are generally indulged in alone, such as jogging?                                | _____ | _____ |
| 29. | Do you cheat on your income tax?   | _____ | _____ |
| 30. | Do you enjoy facing new situations and working out solutions to problems?  | _____ | _____ |
| 31. | Do you enjoy working independently?  | _____ | _____ |
| 32. | Are you able to handle a lot of things at the same time?   | _____ | _____ |
| 33. | Do you revise your goals periodically in view of “progress to date”?   | _____ | _____ |
| 34. | Do you get up early in the morning to work?  | _____ | _____ |
| 35. | When you start a task, do you normally see it through to the end?  | _____ | _____ |
| 36. | When you are the only one in a group with a specific opinion, do you try to convince the others to do it your way? | _____ | _____ |
| 37. | Are you able to make jokes about some of your own failings?  | _____ | _____ |
| 38. | Are you able to discuss wrong decisions you have made in-an analytical rational manner?                            | _____ | _____ |
| 39. | Do you seek contact with people who are used to independent work?  | _____ | _____ |
| 40. | Do you look at problems as opportunities for decision making?  | _____ | _____ |
| 41. | Do you like to be asked for personal advice?   | _____ | _____ |
| 42. | Are you active in outside organisations as a volunteer?  | _____ | _____ |



- |   |       |       |
|---|-------|-------|
| 43. Do you read things outside your own field of work?  | _____ | _____ |
| 44. Do you generally get things done on time?   | _____ | _____ |
| 45. Are you on time for appointments?   | _____ | _____ |
| 46. When working on a job, are you concerned about meeting a specific time schedule?                                | _____ | _____ |
| 47. Have you ever attempted for a second time and succeeded at a project which had previously failed?               | _____ | _____ |
| 48. When entering a new social situation, do you generally feel shy and embarrassed?                                | _____ | _____ |
| 49. Do people come to you for personal advice?  | _____ | _____ |
| 50. Do you make friends easily?   | _____ | _____ |
| 51. When speaking to people, do you generally try to match your vocabulary to that of the person on the other side? | _____ | _____ |
| 52. Do you consider yourself a “hard self”?   | _____ | _____ |
| 53. Do you keep a daily list of “things which must be done”?  | _____ | _____ |
| 54. Do you have a personal lawyer?  | _____ | _____ |
| 55. Do you carry life insurance?  | _____ | _____ |
| 56. Do friends and relatives come to you for various types of business advice?                                      | _____ | _____ |
| 57. After a severe setback in a project, are you able to pick up the pieces and start it again?                     | _____ | _____ |
| 58. Do you like responsibility?   | _____ | _____ |
| 59. Do you laugh easily?  | _____ | _____ |
| 60. Are you in good health?   | _____ | _____ |



- |   |       |       |
|---|-------|-------|
| 61. Do you usually sleep less than eight hours per night?   | _____ | _____ |
| 62. Did you work as a child?  | _____ | _____ |
| 63. Do you usually arrive at airports, train stations or bus stations early, rather than “just in time”?                                    | _____ | _____ |
| 64. When people present ideas to you, do you generally come up with a new “gimmick” or twist?   | _____ | _____ |
| 65. Do you believe that the successful people in the world get there by being lucky?  | _____ | _____ |
| 66. Do you care whether your friends and relatives think you will be successful as an independent business person?                          | _____ | _____ |
| 67. Do you consider yourself a good listener?   | _____ | _____ |
| 68. When faced with a sudden change in plans, are you able to rethink your situation and quickly move ahead on a specific course of action? | _____ | _____ |
| 69. Are you usually able to come up with more than one way to solve a particular problem?   | _____ | _____ |
| 70. Do you enjoy doing “different” things at work?  | _____ | _____ |
| 71. Do you make suggestions about improving things on the job?  | _____ | _____ |
| 72. Do you make a practice of buying things on credit?  | _____ | _____ |
| 73. Do you avoid making decisions when you know the consequences will hurt someone like you?  | _____ | _____ |
| 74. Do you generally listen to people who are older and more experienced than you are?  | _____ | _____ |
| 75. Do you tend to dominate conversations?  | _____ | _____ |



- |  |       |       |
|--|-------|-------|
| 76. Have you taken-any courses which would help you in your job, in the last three years?                  | _____ | _____ |
| 77. Are you between 25 and 40 years of age?  | _____ | _____ |
| 78. Do you read any technical magazines in your primary field of work?                                     | _____ | _____ |
| 79. Do you believe, “If at first you don’t succeed, try, try again”?                                       | _____ | _____ |
| 80. Do you enjoy playing games such as Monopoly?   | _____ | _____ |
| 81. Do you worry when you get in debt?   | _____ | _____ |
| 82. At the end of the day, do you generally have things left over for tomorrow?                            | _____ | _____ |
| 83. Before falling asleep at night, do you often think of new ideas concerning your future plans?          | _____ | _____ |
| 84. When, in a state of depression, do you know that you will soon overcome it?                            | _____ | _____ |
| 85. Have you ever discussed (with others) the idea of going into business for yourself?                    | _____ | _____ |
| 86. Do you face the problems of life with a feeling of hope and good expectations?                         | _____ | _____ |
| 87. Have you ever done anything against the wishes of your family?   | _____ | _____ |
| 88. When you start a task, do you get so involved that you forget everything else?                         | _____ | _____ |
| 89. When people ask you to do things, do you generally accept, or do you beg off because you are too busy? | _____ | _____ |



90. When speaking to people, are you automatically able to put yourself on the same level as others who are participating in the conversation? \_\_\_\_\_
91. Do you feel that most of the events in your life are determined by fate? \_\_\_\_\_
92. Have you at any time and investments in the stock market? \_\_\_\_\_
93. Do you believe in the free enterprise system? \_\_\_\_\_
94. Do you understand basic book keeping principles? \_\_\_\_\_
95. Do you know what the term “Aged Accounts Receivable” means? \_\_\_\_\_
96. Do you have any close relatives who are in business for themselves? \_\_\_\_\_
97. Were either your father or your mother in business for themselves? \_\_\_\_\_
98. Are you over the age of 60? \_\_\_\_\_
99. Do you find most of the people with whom you come in contact, pleasant and friendly? \_\_\_\_\_
100. Does your mood change depending upon the person will whom you are dealing? \_\_\_\_\_
101. Do you consider yourself a person with a “good line” of chatter? \_\_\_\_\_
102. Do you find it easy to set priorities when you have a number of tasks to do in a short period of time? \_\_\_\_\_
103. Do you” get organized” quickly when placed in a new situation at work? \_\_\_\_\_



104. Before making a large purchase, do you generally research the field before going out to look at the item? \_\_\_\_\_
105. Do you need a clear explanation of a task before proceeding with it? \_\_\_\_\_
106. Do you believe time is money? \_\_\_\_\_
107. Do you regularly read any business magazine either at the library or at work? \_\_\_\_\_
108. Are you living at your native place? \_\_\_\_\_
109. Do you regularly read magazine which cover the broad scene? \_\_\_\_\_
110. Are you between 18 and 25 years of age? \_\_\_\_\_
111. Have you ever filed for bankruptcy? \_\_\_\_\_
112. Have you ever exposed yourself to a specific sales situation just to see how the sales person operates? \_\_\_\_\_
113. Do you feel comfortable to discuss with a stranger about the profit and loss of your shopping? \_\_\_\_\_
114. Were either of your grandparents not born at the place where you live present? \_\_\_\_\_
115. Do you put family and/or children first? \_\_\_\_\_
116. Are you able to maintain your self-control when another person is bawling you out for something you did not do? \_\_\_\_\_
117. Do you tend to support your own decisions and opinions vigorously? \_\_\_\_\_
118. Do you want success mainly for yourself, rather than your family? \_\_\_\_\_



- |  |       |       |
|--|-------|-------|
| 119. Do you have a will?   | _____ | _____ |
| 120. When you set a goal, do you generally see it through to the end?  | _____ | _____ |
| 121. Do you know how to read a financial statement?  | _____ | _____ |
| 122. Are proposals you make at meetings, discussion etc. generally accepted?   | _____ | _____ |
| 123. When you are feeling upset, are others usually aware of your problem?   | _____ | _____ |
| 124. When you give directions to others, do they generally come back to you for further clarification?                   | _____ | _____ |
| 125. Is it important to you to know “where the next Rupee is coming from”?   | _____ | _____ |
| 126. When faced with a stalemate situation in a conference, are you able to break the logjam and get “the ball rolling”? | _____ | _____ |
| 127. Can you work long hours without getting tired?  | _____ | _____ |
| 128. Do you feel that most of the events in your life are determined by others?  | _____ | _____ |
| 129. Do you generally “shoot from the hip” when it comes to making decisions?  | _____ | _____ |
| 130. Are you active in politics?   | _____ | _____ |
| 131. Do you seek out situations in which you will have extra responsibility?   | _____ | _____ |
| 132. Do you act quickly in cases of emergency, such as accidents, fire, etc.?  | _____ | _____ |



- |  |       |       |
|--|-------|-------|
| 133. Are you able to stop drinking, smoking, or eating at a specific point in time?                    | _____ | _____ |
| 134. Do you fall in and out of love easily?  | _____ | _____ |
| 135. When you make up your mind to do something, do you generally do?                                  | _____ | _____ |
| 136. Do you often write memos or letters about business matters?                                       | _____ | _____ |
| 137. Have you ever borrowed money from friends or relatives?   | _____ | _____ |
| 138. Do you work well under pressure?  | _____ | _____ |
| 139. Have you ever skipped lunch or dinner to complete a task?   | _____ | _____ |
| 140. Do you have a way of life which considers money “easy come, easy go”?                             | _____ | _____ |
| 141. Have you ever sold anything at any time?  | _____ | _____ |
| 142. Are you in sales now?   | _____ | _____ |
| 143. Do you generally pay attention to your boss and do it “that way”?                                 | _____ | _____ |
| 144. In voluntary organisations, do you ordinarily win up as an officer or as chairman of a committee? | _____ | _____ |
| 145. Have you ever done fund raising for a charity or a religious social cause?                        | _____ | _____ |
| 146. Do you find it easy to express new ideas quickly and understandably?                              | _____ | _____ |
| 147. Have you ever supervised people?  | _____ | _____ |
| 148. Are you good with numbers?  | _____ | _____ |





149. Do you feel that most of the events in your life are determined by yourself? \_\_\_\_\_
150. Do you make it a practice to buy things for cash? \_\_\_\_\_
151. Do you usually get eight hours sleep per night? \_\_\_\_\_
152. Do you know a banker on a first-name basis? \_\_\_\_\_
153. Do you know what the term “cash flow” means? \_\_\_\_\_
154. When you run across a new idea, do you try to find out about it by reading about and asking people about it? \_\_\_\_\_
155. Did you act as an independent business person as a child Paper route, lemonade stand, etc.? \_\_\_\_\_
156. Have you been successful in attaining most of your long-range goals? \_\_\_\_\_
157. Before falling asleep at night, do you normally plan out what you are going to do the next day? \_\_\_\_\_
158. When people criticize you, do you take it kindly and try to change? \_\_\_\_\_
159. Do you consider yourself smarter than most bosses you have ever had? \_\_\_\_\_
160. Are you in serious financial trouble now? \_\_\_\_\_
161. Do you play cards for money regularly? \_\_\_\_\_
162. Are you between 40 and 60 years of age? \_\_\_\_\_

**Friedman Self-Assessment Questionnaire Answer Sheet**

Question	Answer	Category	Question	Answer	Category
1	Y	C	21	Y	C



2	Y	C	22	N	0
3	Y	C	23	N	B
4	Y	C	24	Y	M
5	Y	L	25	Y	L
6	N	F	26	Y	A
7	Y	H	27	Y	I
8	Y	H	28	Y	B
9	Y	A	29	Y	G
10	Y	G	30	Y	H
11	Y	I	31	Y	B
12	Y	C	32	Y	J
13	Y	Q	33	Y	A
14	Y	B	34	Y	I
15	N	B	35	Y	A
16	Y	R	36	Y	B
17	N	E	37	Y	E
18	Y	L	38	Y	E
19	N	I	39	Y	L
20	N	B	40	Y	D

Question	Answer	Category	Question	Answer	Category
41	Y	H	61	Y	I
42	Y	H	62	Y	S
43	Y	M	63	Y	D



44	Y	D	64	Y	K
45	Y	D	65	N	F
46	Y	D	66	N	F
47	Y	E	67	Y	C
48	N	B	68	Y	K
49	Y	B	69	Y	K
50	Y	B	70	Y	K
51	Y	C	71	Y	K
52	Y	B	72	Y	G
53	Y	K	73	N	K
54	Y	L	74	Y	L
55	Y	O	75	Y	H
56	Y	H	76	Y	M
57	Y	E	77	Y	P
58	Y	H	78	Y	M
59	Y	B	79	Y	E
60	Y	I	80	Y	G

Question	Answer	Category	Question	Answer	Category
81	N	G	101	Y	B
82	Y	A	102	Y	K
83	Y	A	103	Y	J
84	Y	E	104	Y	K
85	Y	L	105	N	J



86	Y	F	106	Y	O
87	Y	G	107	Y	M
88	Y	I	108	N	R
89	N	H	109	Y	M
90	Y	C	110	N	P
91	N	F	111	N	O
92	Y	G	112	Y	L
93	Y	N	113	Y	L
94	Y	N	114	N	R
95	Y	N	115	N	F
96	Y	Q	116	Y	F
97	Y	Q	117	Y	F
98	N	P	118	Y	F
99	Y	B	119	Y	O
100	N	B	120	Y	A

Question	Answer	Category	Question	Answer	Category
121	Y	N	142	Y	B
122	Y	H	143	N	S
123	N	B	144	Y	H
124	N	C	145	Y	H
125	N	J	146	Y	C
126	Y	H	147	Y	M
127	Y	I	148	Y	M



128	N	F	149	Y	F
129	N	A	150	N	G
130	Y	H	151	N	I
131	Y	H	152	Y	O
132	Y	I	153	Y	O
133	Y	D	154	Y	M
134	N	A	155	Y	S
135	Y	A	156	Y	A
136	Y	C	157	Y	A
137	N	G	158	N	F
138	Y	I	159	Y	S
139	Y	I	160	N	O
140	N	O	161	Y	G
141	Y	B	162	Y	P

### FRIEDMAN SELF-ASSESSMENT QUESTIONNAIRE EVALUATION METHOD

Compare the answer you have circled on the questionnaire form with the answer sheet provided. Put a circle around all answers on the answer sheet that correspond with the answers you marked on the questionnaire. Make an “x” through all answers that do not correspond with one another. Does this task very carefully and thoroughly double-check your work? When your work is finished, the answer sheet should have circle around those answers that are the different from those on your questionnaire. The questions you did not answer will have either a circle around them or an “x” through the answer on the answer sheet.

Now, do the following:



- Count the number of circled answers. Write this number here\_\_\_\_\_.
- Count the number of answers with an “x” through them. Write this number here\_\_\_\_\_.
- Add the numbers from lines (a) and (b). Write the sum here\_\_\_\_\_.
- Divide the number in line (a) by the number in line (c). Multiply the number in line (d) by 100.

The number in line (e) is the percentage of answers that are correct. If this figure is 60 per cent or lower, you should probably think a lot about whether you are really suited for a business of your own. The higher the number, the better you appear to be suited for becoming an owner/operator of a business.

For further clarifications of the specific characteristics and attitudes tested and how you rate in each category, compare your answers with the material that discusses the relationship between the question categories and the questions themselves.

Hopefully this must have been an enlightening and rewarding experience for you:

### **Relationship between Question Categories and Questions**

**Category A: Goal setting and Perseverance** – It is important for the owner/operator to have the ability to set clear goals and objectives which are high and challenging, and at the same time realistic and attainable. Concurrently, there must be a commitment to long-term future projects and to working toward goals which might be quite distant in the future. Essential success as an owner/operator is a strong determination to get the job done at almost any cost in terms of personal sacrifice.

Questions: 9, 26, 33, 35, 82, 83, 120, 129, 134, 135, 156, 157.

**Category B: Human Relationship Ability** – The successful owner/operator needs to be able to sell. This means the ability to convince others to move in specific directions. This cannot generally be done if the person does not have good relations with others. Characteristics such as cheerfulness, cooperation and tact are all important.

Questions: 14,15,20,23, 28, 31,36,48,49,50,52,59,99,100,101,123,141,142.

**Category C: Communications Ability** – Verbal communications, verbal and written comprehensions, and written communications ability are necessary for the owner/operator. The ability to communicate ideas to others is vital in every business but imperative in the small business.



Questions: 1,2,3,4, 12, 21, 51, 67, 90, 124, 136, 146

**Category D: Competing Against Self-Imposed Standards** – The desire and tendency to set self-imposed standards which are high, yet realistic, and then to compete with oneself is important for the success of an owner/operator. Since the goals of the business are set by the owner and met by the operator, the small business must rely on the individual person who does both task if it is to become successful. There is no one to blame for failure in a small business other than the person who wears all the hats.

Questions: 40, 44, 45, 46, 63, 133.

**Category E: Dealing with Failures** – Since things rarely go right the first time in a small business, it is imperative that the owner/operator learns to use failure as a means of gaining a better understanding of how to prevent the same thing from happening again.

Questions: 17, 37, 38, 47, 57, 79, 84.

**Category F: Self-Confidence and Belief in Self-Determination** – The owner/operator must have a firm belief (in his or her ability to achieve goals that are self-determined. It is also vital that the person has the belief that success and failure are within one's personal control rather than being determined by luck.

Questions: 6, 65, 66, 86, 91, 115, 116, 117, 118, 128, 149, 158.

**Category G: Moderate Risk-Taking** – Since there is risk involved in every business enterprise the owner/operator should 'have predisposition to take moderate, calculated risks which provide a reasonable chance for success.

Questions: 10, 29, 72, 80, 81, 87, 92, 137, 150, 161

**Category H: Taking Initiative and Seeking Personal Responsibilities** – There is no one at the back of an owner/operator making important decisions or determining what comes next. An important ingredient of success is to fill a leadership vacuum where one exists. In addition, the would-be owner/operator should like situations in which one's impact on problems can be measured.

Questions: 7,8,30,41,42,56,58,75,89,122,126, 130, 131, 144, 145



**Category I: Drive and Energy Level** – Running one's own business in hard work. The owner/operator should have the ability to work long hours with less than normal sleep. Vigor, good health and persistence are very important.

Questions: 11, 19, 27, 34, 60, 61, 88, 127, 132, 138, 139, 151.

**Category J: Tolerance for Ambiguity** – Every small business has many crises which can only be solved by the owner/operator. One should have the ability to live with modest-to-high levels of uncertainty concerning job and career security and to be able to work on a number of different tasks simultaneously.

Questions: 32, 103, 105, 125

**Category K: Thinking Ability** –To Be a successful owner/operator and independent business person, there is a need for original thinking, creativity and critical analysis of situations. Problem-solving ability is of prime importance, particularly if it can be done well under pressure.

Questions: 53, 64, 68, 69, 70, 71, 102, 104.

**Category L: Use of Outside Resource Persons** –The owner/operator, must have the demonstrated capacity to seek and use the opinions of others in order to take corrective action and to improve the quality of business decisions. This is an orientation which seeks to obtain expertise and assistance in the accomplishment of goals.

Questions: 5, 18, 25, 39, 54, 74, 85, 112, 113

**Category M: Technical Knowledge** – It is dangerous for a person to go into a business which is unknown territory. If the would-be owner/operator does not have the requisite knowledge then it should be obtained through a self-study program, working as an employee in a similar business, obtaining a franchise, taking a partner or hiring an experienced employee. Some of these latter options are obviously dangerous since they put the owner/operator at the mercy of others.

Questions: 24, 43, 76, 78, 107, 109, 147, 148, 154

**Category N: Number Sense** – Business success is evaluated through a series of accounting reports. A person does not have to be an expert in understanding these reports, but “numbers” should not frighten





the would-be business person. Sooner or later, important decisions will have to be made based on the “numbers”. The better the owner/operator is able to understand these figures, the better the decision will be.

Questions: 93, 94, 95, 121.

**Category O: Money Sense** – The owner/operator must recognize that money is an important factor in running a business. Gaining an early respect for money and learning how to use it is important if a dependent business person is to succeed.

Questions: 22, 55, 106, 111, 119, 140, 152, 153, 160.

**Category P: Age** – There is no “magic age”. Generally, the successful owner/operator has to be old enough to have had life experiences without having the stuffing completely knocked out. Ages 30-35 seem to be a time in life when people are willing to strike out on their own. Another significant age bracket is 50-55 when things are settled financially and a person can look around at new opportunities.

Questions: 77, 98, 110, 162.

**Category Q: Family Background** – A Successful owner/operator seems to have a family back ground that shows evidence of entrepreneurial endeavor on the part of the father, mother and close family relative.

Questions: 13, 96, 97.

**Category R: Ethnic Background** –Migrants have a higher incidence of going into business for themselves than native-born- people do.

Questions: 16,108, 114.

**Category S: Employment History** – People who really want to go business for themselves have a hard time working for others. Most bosses aren’t as smart as they are, and the job seems to get dull very quickly.

Questions: 62, 143, 155, 159.



<b>Subject:</b> Entrepreneurship Development	
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<b>ENTREPRENEURIAL MOTIVATION</b>	

## Structure

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## 4.0 Learning Objectives

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

- Define motivation
- Understand to differentiate between need, incentives and motives
- Discuss the various theories of motivation
- Explain the motives for starting a enterprise
- Elaborate the Achievement Motivation Theory

## 4.1 Introduction

Entrepreneur is human being who has his dignity, self-respect, values, sentiments, aspirations, dreams apart from economic status. Indeed, economic betterment and social upliftment motivates a person to distinguish from others. Entrepreneurship is to a great extent the product of motivation. Motivation refers to the inner drive that ignites and sustains behavior to satisfy needs. Behavior is always caused and it is not spontaneous. In other words, human behavior is goal directed or directed towards satisfaction of needs. A person's behavior is shaped by several socio psychological factors such as his goals, education level, cultural background, work experience, etc. When a person, feels some need tension arises in his mind until the need is satisfied. The tension motivates him to take action. If the action is successful need is satisfied otherwise the person changes the action until the need satisfaction occurs.

By now, you have learnt what an entrepreneur is and does. You have also learnt that the entrepreneurs play a risk-bearing role which is a difficult one. The entrepreneur embarks on a difficult journey. Then, a few important and obvious questions arise: What prompts people to embark on such a difficult journey? What motivates people to go into business? This lesson intends to answer these questions/issues by discussing entrepreneurial motivation in its various aspects viz. meaning and theories of motivation, motivating factors and development of achievement motivation.

## 4.2 Concept of Motivation

The term 'motivation' has its origin in the Latin word "*movere*" which means to "move". Thus, motivation stands for movement. One can get a donkey to move by using a "Carrot or a stick", with



people one can use incentives, or threats or reprimands. However, these only have a limited effect. These work for a while and then need to be repeated, increased or reinforced to secure further movement. The term motivation may be defined as “the managerial function of ascertaining the motives of subordinates and helping them to realize those motives.”

Whatever may be the behavior of a man, there is always some stimuli that elicit the behavior. Stimulus is often dependent upon the motive of the person concerned. Motive can be known by studying his needs and desires. There is no universal theory that can explain the factors influencing motives which control man's behavior at any particular point of time. Generally, different motives operate at different times among different people and influence their behavior. The management should try to understand the motives of individuals which cause different types of behavior.

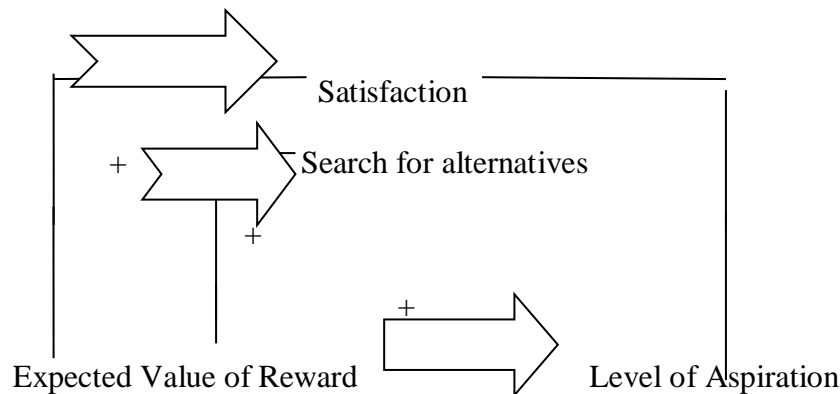
According to Dubin, motivation could be defined as “the complex of forces starting and keeping a person at work in an organization. Motivation is something that moves the person to action, and continues him in the course of action already initiated”. Motivation refers to the way a person is enthused at work to intensify his/her desire and willingness to use and channelize his/her energy for the achievement of organizational objectives. It is something that moves a person into action and continues him in the course of action enthusiastically. The role of motivation is to develop and intensify the desire in every member of the organization to work effectively and efficiency in his position.

In the words of Dalton E. McFarland, “Motivation is the way in, which urges desires, aspirations, striving or needs direct, control or explain the, behavior of human being”. Motivation has very close relationship with the behavior. It explains how and why the human behavior is caused. According to McFarland motivation is a form of tension occurring within individuals, with resulting behavior aimed at reducing, eliminating or diverting the tension. Understanding the needs and drives and their resulting tensions helps to explain and predict human behavior ultimately providing a sound basis for managerial decision and action. Thus, motivation is the term which applies to the entire class of urges, drives, desires, needs and similar forces.

March and Simon have developed a model, according to which motivation is the process or the reaction which takes place in the memory of the individual. It may be viewed as the combination of forces or motives maintaining human activity. Motivation to produce is a function of the character of the evoked



set of alternatives, the perceived consequences of evoked alternatives and individual goals in terms of which alternatives are evaluated. March and Simon have established positive correlation between productivity and motivation by means of a theoretical model shown in Figure I.



**Figure I: March and Simon's Motivation Model**

The main implications of this model are as under:

- If lower the individual satisfaction, greater the search for better ways of doing the job.
- With more searches for alternative, greater is the expectation of rewards.
- When greater the expected rewards, the higher the satisfaction and level of aspiration.
- When higher the level of aspiration, lower the satisfaction.

The unsatisfied need of a person is the beginning of the motivation process. The unsatisfied need results in tension within the individual and motivates him to search for the ways to relieve this tension, and compels or develops certain goals for him. If he is successful in achieving his goals, certain other needs will emerge which will lead to setting a new goal. But if the goal is not achieved, the individual will engage himself in either constructive or destructive behavior. This process never stops. It keeps on working within an individual.

#### **4.2.1 Difference between Needs, Incentives and Motives**

A distinction may be made among three things: need, incentive and motive. This is to emphasize that any need present in the individual does not necessarily lead to action. The need has to be activated which is the function of incentive. Incentive is something which incites or tends to incite towards some determination. Thus, incentive is an external stimulus that activates need and motive refers to an



activated need, and active desire or wish. But a better definition is to regard incentive as the outward stimulus for the motive to work. When a motive is present in a person, it becomes active when there is some incentive. Thus, any incentive has reference to (i) the individual and his needs which he is trying to satisfy or fulfill; and (ii) the organization which is providing the individual with opportunity to satisfy his needs in return for his services. Thus, conceptual difference between motivation and incentive is that incentive is the means to motivation.

It is, clear that incentive has direct bearing on the degree of motivation. Increase in incentive leads to better performance and decrease in incentive has adverse effect on performance. It should be noted that motivation does not change the individual's capacity to work. It simply determines the level of the effort of individual raises it or lowers it, as the case may be. Keith Davis feels that motives are expression of a person's need; hence, they are personal and internal. Incentives, on the other hand, are external to the person. They are something he perceives in his environment as helpful towards accomplishing his goal. For instance, management offers salesmen a bonus as an incentive to channel in productive way their drives for recognition and status.

Need creates tension, which is modified by one's culture to cause certain wants. These wants are interpreted in terms of positive and negative incentives to produce a certain response or action. To illustrate, need for food produces a tension of hunger. Since culture affects hunger, a man will require wheat or rice accordingly. For a man, perhaps incentive is provided by his wife's promise to prepare food in his favorite way.

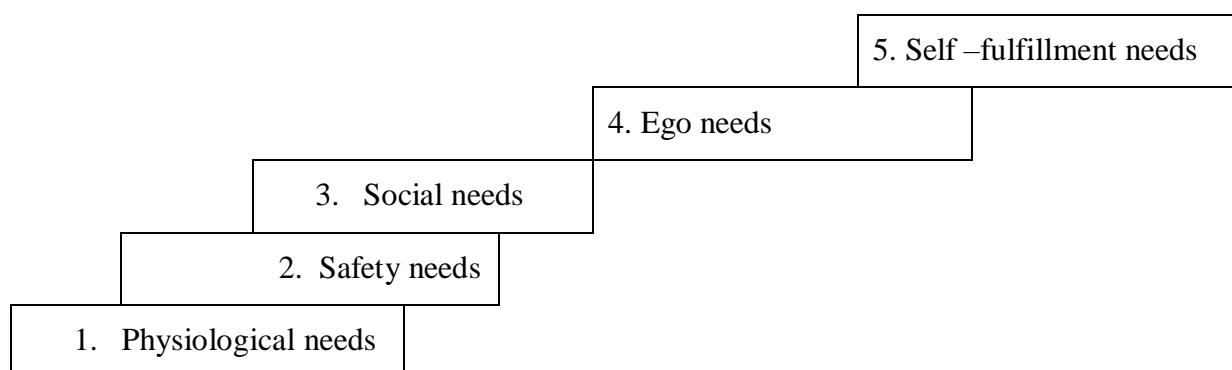
### 4.3 Theories of Motivation

The importance of motivation to human life and work can be judged by the number of theories that have been propounded to explain human's behavior. They explain human motivation through human needs and human nature. Prominent among these theories which are particularly relevant to entrepreneurship are Maslow's Need Hierarchy Theory and McClelland's Acquired Needs Theory.

**4.3.1 Maslow's Need Hierarchy Theory**-Prof A. H. Maslow developed a theoretical framework for understanding human motivation which has been widely acclaimed. According to him, a person's effectiveness is a function of matching his opportunity with the appropriate position of hierarchy of needs. Process of motivation begins with an assumption that behavior, at least in part, is directed



towards the satisfaction of needs. Maslow proposed that human needs can be arranged in a particular order from the lower to the higher as shown in Figure II. The need hierarchy is as follows:



**Figure II: Maslow's Need Hierarchy**

- **Basic Physiological Needs:** The physiological needs relate to the survival and maintenance of human life. These needs include such things as food, clothing, air, water and other necessities of life which are biological in nature. These needs are primary needs.
- **Safety and Security Needs:** After satisfying the 'physiological needs, people want the assurance of maintaining a given, economic level. They want job security, personal bodily security, security of source of income, provision for old age, insurance - against risks, etc.
- **Social Needs:** Man is a social being. He is, therefore, interested in conversation, sociability, exchange of feelings and grievances; companionship, recognition, belongingness, etc.
- **Esteem and Status Needs:** These needs embrace such things as self-confidence, independence, achievement, competence, knowledge and success. These needs boost the ego of individual. They are also known as egoistic needs. They are concerned with prestige and status of the individual.
- **Self-Fulfilment Needs:** The final step under the need priority model is the need for self-fulfilment or the need to fulfil what a person considers to be his mission in life. It involves realizing one's potentialities for continued self-development and for being creative in the broadest sense of the word. After his other needs are fulfilled, a man has the desire for personal achievement. He wants to do something which is challenging and since this challenge gives him enough dash and initiative to work, it is beneficial to him in particular and to the society in general. The sense of achievement gives him psychological satisfaction.



Maslow felt that the needs have a definite sequence of domination. Second need does not dominate until first need is reasonably satisfied and third need does not dominate until first two needs have been reasonably satisfied and so on. The other side of the needs hierarchy is that man is a wanting animal, he continues to want something or the other. He is never fully satisfied. If one need is satisfied, the other need arises.

As said above (according to Maslow), needs arise in a certain order of preference and not randomly. Thus, if one's lower level needs (physiological and security needs) are unsatisfied, he can be motivated only by satisfying his lower level needs and not satisfying his higher level needs. Another point to note is that once a need or a certain order of needs is satisfied, it ceases to be a motivating factor. Man lives for bread alone as long as it is not available. In the absence of air one can't live, it is plenty of air which ceases to be motivating.

The physiological and security needs are finite and tangible, but the needs of higher order are sufficiently infinite and are likely to be dominant ones in persons at higher levels in the organization. This has been proved by various studies. A study by Boris Blai supported this by showing that managers and professionals in U.S.A. highly value self-realization, while service and manual workers value job security most highly. Further, a survey of 200 factory workers in India reported that they give top priority to job security, earnings and personal benefits - all lower order needs. Studies have also revealed that those needs, which are thought to be most important like social needs, egoistic needs and self-realization, are also thought to be the best satisfiers. One study on two thousand and eight hundred managers in eleven countries reported that security; belongingness esteem and self-realization needs are progressively less satisfied according to the pattern of the needs priority model.

➤ **Appraisal of Need Hierarchy Model:** The need priority model may not be applied at all times in all places. Surveys in continental European countries and Japan have shown that the model does not apply very well to their managers. Their degrees of satisfaction of needed does not vary according to the need priority model. For example, workers in Spain and Belgium felt that their esteem needs are better satisfied than their security and social needs. Apparently, cultural differences are an important cause of these differences. Thus, need hierarchy may not follow the sequence postulated by Maslow. Even if safety need is not satisfied, the egoistic or social need may emerge.





Proposition that one need is satisfied at one time is also of doubtful validity. The phenomenon of multiple motivations is of great practical importance in understanding the behavior-of man. Man's behavior at any time is mostly, guided by multiplicity of motives. However one or two motives in any situation may be proponent, while, others may be of secondary importance. Moreover, at different levels of needs, the motivation will be different. Money can act as a motivator only for physiological and social needs, not for satisfying higher level needs. Employees are enthusiastically motivated by what they are seeking, more than by what they already have. They may react cautiously in order to keep what they already have, but they move forward with enthusiasm when they are seeking something else. In other words, man works for bread alone as long as it is not available.

There are always some people in whom, for instance, need for self-esteem seems to be more prominent than that of love. There are also creative people in whom the drive for creativeness seems to be more important. In certain people, the level of operation may be permanently lower. For instance, a person who has experienced chronic unemployment may continue to be satisfied for the rest of his life if only he can get enough food. Another cause of reversal of need hierarchy is that when a need has been satisfied for a long time, it may be under-valued.

**4.3.2 McClelland's Acquired Needs Theory-**Each person tends to develop certain motivational drives as a result of his cognitive pattern and the environment in which he lives. David McClelland gave a model of motivation which is based on three types of needs, namely, achievement, power and affiliation. They are as follows:

- **Need for achievement (n-Ach):** a drive to excel, advance and grow;
- **Need for power (n-Pow):** A drive to influencing others and situations; and
- **Need for affiliation (n-Aft):** A drive for friendly and close interpersonal relationships.
- **Achievement Motivation:** Some people have a compelling drive to succeed and they strive for personal achievement rather than the rewards of success that accompany it. They have a desire to do something better or more efficiently than it has been done before This drive is the achievement need (n-Ach). From researches into the area of achievement need, McClelland found that high achievers differentiate themselves from others by their desire to do things better. They seek situations where they can attain personal responsibility for finding solutions to, problems, where they can receive



rapid feedback on their performance so they can set moderately challenging goals. High achievers are not gamblers; they dislike succeeding by chance. They prefer the challenge of working at a problem and accepting the personal responsibility for success or failure, rather than leaving the outcome to chance or the actions of others.

- **Power Motivation:** The need for power (n-Pow) is a drive to have impact, to be influential, and to control others. Individuals high in n-Pow enjoy being “in charge”, strive for influence over others, prefer to be placed into competitive and status-oriented situations, and tend to be more concerned with gaining influence over others and prestige than with effective performance. Power-motivated people wish to create an impact on their organizations and are willing to take risks to do so.
- **Affiliation Motivation:** This need has received the least attention of researchers. Affiliation need (n-Aft) can be viewed as the desire to be liked and accepted by others. It is the drive to relate to people on a social basis. Individuals with a high affiliation motive strive for friendship, prefer cooperative situations rather than competitive ones, and desire relationships involving a high degree of mutual understanding.

People possess the above needs in varying degrees. However, one of the needs will tend to be more characteristic of the individual rather than the other two. Individual with a high-need for achievement thrive on jobs and projects that tax their skills and abilities. Such individuals are goal-oriented in their activities, seek a challenge and want task relevant feedback. Individuals with high affiliation needs value interpersonal relationships and exhibit sensitivity towards other people's feeling. But individuals with the high power needs seek to dominate, influence or have control over others.

McClelland also suggests that these three needs may simultaneously be acting on an individual. But, in case of an entrepreneur, the high need for achievement is found dominating one. In his view, the people with high need for achievement are characterized by the following:

- They set moderate, realistic and attainable goals for them.
- Prefer to situations in which they can find solutions for solving personal responsibility.
- They need concrete feedback on how well they are doing.
- They have need for achievement for attaining personal accomplishment.
- They look for challenging tasks.



Entrepreneurial motivation may be defined as a set of motives such as high need to achieve, moderate need for power and low affiliation motive which induce people to set up and run their own enterprises. Apart from these, entrepreneurs have other behavioral dimensions such as, tolerance for ambiguity, problem solving, creativity, etc.

#### **4.3.3 Motives for Starting Enterprises**

Several researchers have carried out research studies to identify the factors that motivate people to start business enterprises. The findings of some of the studies are as follows.

1. In this pioneering study, R.A. Sharma classified all the factors motivating the entrepreneurs into two types as follows:

##### **(i) Internal factors**

- Educational background
- Occupational experience
- Desire to do something pioneering and innovative
- Desire to be free and independent
- Family background

##### **(ii) External factors**

- Assistance from Government
- Financial assistance from institutions
- Availability of technology and/or raw materials
- Encouragement from big business units
- Heavy demand for product
- Others.

Internal factors constitute the personality of the entrepreneur and thereby generate an inclination to adopt entrepreneurial activity. The presence of these factors is essential for entrepreneurial activity to take place. But entrepreneurial ambitions cannot fructify without a supporting environment. External factor prove environment and give a spark to entrepreneurship.



Among the internal factors, the desire to do something creative was important. It means the desire to make a contribution to the development of the state, to introduce an entirely new product in the market, to place the home town on the country's industrial map, to make full use of technical skills, to provide employment to intelligent young men and women in the community, etc. Occupational experience (familiar with the product, knowledge of the market, etc.) was rated as the second most important internal motive. Business experience provides confidence for starting anew enterprise. Technicians, engineers and executives rated business experience more important motivator than other types of entrepreneurs.

Among the external factors, assistance from financial and other Governmental institutions was rated the strongest motivator. Other factors include availability of surplus funds, sick units available at a cheap price, success stories of first generation entrepreneurs, support of mends and relatives, etc. In some cases there were compelling reasons like loss of job, death of the father dissatisfaction with the job held, etc., prompting people to launch their own industries.

2. H. N. Pathak indicated that at small scale level, profit motive inspired small scale entrepreneurs. Ambition for independent working in industry also motivated non-corporate level entrepreneurs. Sharma's study also revealed that motivating factors varied according to the, occupation background of entrepreneurs. Business executives, engineers, consultants, traders, considered occupational experience as most important. According to McClelland, executive generally have higher need for a achievement than men in other occupations. On the other hand, government servicemen, contractors and entrepreneurs from agricultural activities considered assistance from government and financial institutions as the most important factor.

3. After making different studies on technical and new entrepreneurship, Arnold C. Copper concluded that there are three main groups of factors which influence an entrepreneur. These are (i) the characteristics of the entrepreneur including many aspects of his background (family, education, age; occupational experience, etc.) which make him more or less, inclined towards entrepreneurship. These might be called "internal factors" (ii) the organisation for which he has been working earlier which might be termed as the incubator organisation (iii) a complex of 'external influences' including the availability of venture capital, collective attitudes and perceptions leading to entrepreneurship, and the accessibility to suppliers, personnel and markets.



4. Another- study by Murthy, Sekhar and Rao on entrepreneurial motivation classified the factors behind entrepreneurial growth into three categories as follows:

**1. Entrepreneurial ambitions**

- To make money
- To continue family business
- To secure self-employment/independent living
- To fulfill desire of self/wife/parents
- To gain social prestige
- Other ambitions-making of a decent living, self-employment of children, desire to do something creative, provide employment to others.

**2. Compelling reasons**

- Unemployment
- Dissatisfaction with the job so far held or occupation pursued
- Make use of idle funds
- Make use of technical/professional skills.
- Others-maintenance of large families, revival of sick unit started by father, etc.

**3. Facilitating factors**

- Success stories of entrepreneurs
- Previous association (experience in the same or other line of activity)
- Previous employment in the same or other line of activity
- Property inherited/self-acquired/wives
- Advice or influence (encouragement) of family members/relatives/mends.
- Others- association as apprentices and sleeping partners.

The study was conducted on 334 entrepreneurs in two coastal towns of Anakapalli and Gudivada of Andhra Pradesh. The ambitions of continuing family business and securing self-employment emerged as the most significant motivating factors. Making money and gaining social prestige were found to be insignificant.



May a time, it is the compulsion rather than the ambition that leads the man to success. Sometimes the initial ambition and the opportunities may clash with each other. In such cases, compulsion of the situation determines the destiny. Therefore, it is, appropriate to examine the reasons that might have compelled the entrepreneurs to, pursue entrepreneurship. Making use of technical and professional skills was found to be the most important compulsion that has driven most of the respondents to entrepreneurship. Dissatisfaction in the job or occupation pursued was the second important compulsion and other compelling factors were insignificant. It may be inferred that the entrepreneurs wanted to capitalize their skills for themselves than working for others. They felt that their abilities were certainly more than what the job required and their aspirations exceeded what normally the job provided.

Ambitions or compulsions alone may not make a man an entrepreneur. The moral support and encouragement of family members, friends and relatives, previous experience and inherited property are very helpful in the growth of entrepreneurship. Moral support from the near and dear inspires would be entrepreneur, reinforces his confidence and prepare him to face the new challenges boldly.

Among the facilitating factors, previous association in the same or other line of activity was rated highest followed by previous employment in the same or other line of activity. Previous association and employment gave abundant self-confidence. Previous employment here meant a person being employed for making a living. On the other hand, previous association implied apprenticeship in business firms. Most of the entrepreneurs expressed the view that it was better to get the training as apprentices or employees before setting up an enterprise. Such experience instills confidence among the youth, serves as the nursery for building the enterprise and accelerates the process of generation of entrepreneurship.

The success stories of entrepreneurs were recognized as an important factor that inspired new entrepreneurs. This finding points out the need for introduction of entrepreneurial stories in school curriculum along with the stories of political leaders and social reformers. This is in conformity with Eugene Staley's pilot study in Osmanabad (Maharashtra). Unfortunately, in India successful business leaders are denigrated by politicians. This generates a sense of hatred in the minds of youth towards leaders of industry, an impression is created that entrepreneurship itself is something unethical or antisocial. Such an impression thwarts the healthy growth of, entrepreneurship in the country.



The study by Murthy *et.al* also revealed that the family property and assistance from relatives and friends was the most significant source of initial capital for an entrepreneur. Such risk capital from family funds enhanced the entrepreneur's trustworthiness in the money market and relived him from the fear of the business failure. It indicated the family's confidence in the entrepreneur and the family's willingness to risk saving in entrepreneurial activities. Thus, in Indian society entrepreneurship cannot be considered as an individual phenomenon and strictly intrinsic to the person involved. Rather it is an extension of the family aspirations and ambitions that are ultimately realized by an individual.

Contrary to the general expectations, the entrepreneur's wife, family members and relatives were found to be the prime motivators who instilled the spirit of entrepreneurship in the entrepreneur. They served as philosopher and guide to the individual and the role of the Government as motivator was insignificant. It may be, concluded that entrepreneurship is the result of encouragement and support by wife and family members apart from the individual's own initiative.

McClelland and his associates contend that need for achievement is a prerequisite for becoming an entrepreneur. People with a high level of achievement motivation are likely to behave in an entrepreneurial way. But it is not essential that such people will actually become entrepreneurs. Such persons are likely to be attached towards business only if business enjoys a high prestige in society. Thus, the relationship between achievement need and occupational preference depends on the prestige of the occupation, concerned.

Murthy analyzed the entrepreneurs' perception of different occupation in terms of the social status of these occupations. Trading was ranked first and farming was ranked last by the entrepreneurs. It was further enquired how the entrepreneurs rated their present occupation. Entrepreneurs engaged in trading and manufacturing rated their occupations as the best. But most of the farmers did not rate farming as the best occupation.

Caste wise perception of the occupation in terms of social image was also analyzed. Entrepreneur's perception with different caste origins different markedly. The analysis indicated that farmers might like to change to non-farming and traders to manufacturing because they carry higher image in the public mind.



5. Two subsequent studies in Andhra Pradesh have by and large corroborated the findings of Murthy, *et. al* In his study of 87 manufacturing units in thirteen industrial estates of Andhra Pradesh, N. Gangadhar Rao found that making money is the most important ambition and fulfillment of the desire of self/wife/father as the second important ambition. However, the aggregate pull of non-money ambitions was found to be more than twice of the money ambitions. Family members play useful role in giving shape to entrepreneurial ambitions. In view of the significance of earning motive, achievement motivation programmes should be designed to inculcate ambition for money. Among the compelling reasons, dissatisfaction with the job held so far or the occupation so far pursued was rated the highest followed by making use of idle funds. Inherited property, technical and professional qualifications, and success stories of entrepreneurs were found to be significant among the facilitating factors. Rao expanded the list of facilitating factors to include (i) technical and professional skills acquired; (ii) allotment of plot/shed in industrial estate; (iii) financial assistance from State agencies, banks, family, friends and relatives; (iv) ancillary relation with large firms; and (v) dependable partners.

Majority of the entrepreneurs considered themselves as self-developed and made no mention of their friend, philosopher and guide. This is a testimony of the resourcefulness of the entrepreneurs and it is this class of entrepreneurs that are needed most. About 47 per cent of the entrepreneurs mentioned their family members, relatives, friends, former employers, industrial leaders and politicians as their mentors. This gives the impression that entrepreneurship can be induced easily.

6. In another similar study of 40 enterprises in Marripalem and Autonagar industrial estates of Andhra Pradesh, Ashok Kumar found that to become self-reliant and to materialize one's ideas and skills were the most significant ambitions. Dissatisfaction with the earlier job and dependency situation were the main factors that compelled the respondents to become entrepreneurs. Among the facilitating factors, education, training and previous job experience was the most important.

The entrepreneur might have come on his own or on being encouraged by others. Therefore, an attempt was made to ascertain the man responsible for infusing the spirit of enterprise. Nearly one half of the entrepreneurs were self-motivated whereas around one- third of them were motivated by friends and relations and the remaining by their parents.





Entrepreneurship is not an accident, but an ambition or aspiration nourished over a period of time. In many a case; entrepreneurship takes a long time to unfold itself. The interval between conceiving an idea and materializing the same may range from a few years to a few generations. Therefore, it was attempted to find out whether the entrepreneurs had aspired for it in their childhood. It was found that nearly two thirds of the respondents had aspired for entrepreneurship during their childhood itself.

V.L. Rao has summarized the views of various experts on sources of entrepreneurial supply and motivation in the form of a table which is given below:

**Table I: Entrepreneurship: Sources of Supply and Motivation**

<b>Author</b>	<b>Entrepreneurial phenomenon</b>	<b>Source of Entrepreneurial supply</b>	<b>Motive force or triggering factor</b>
<b>Schumpeter</b>	Individual	Extraordinary individuals	Innate urge to achieve success
<b>Weber</b>	Status groups	Extraordinary individuals	Religious beliefs, Calvinist ethic
<b>McClelland</b>	Religious social groups	Individual with high n-achievement, creative.	Child-rearing practices and climate
<b>Hagen</b>	Subordinated Groups	Individuals in the society driven by a duty to achieve	Status withdrawal and relative social blockage.
<b>Cochran</b>	Individual	Society's model personality determined by its cultural values, role expectations and social sanctions.	Social Acceptance of entrepreneurial role
<b>Young</b>	Homogeneous	'Relative sub-groups' (ethnic communities) occupational groups, or Politically-oriented factions.	Deviant view of the world strength themed by group solidarity.



<b>Kunkel</b>	Group	Operant conditioning procedures in a society.	Reinforcing stimuli and average stimuli.
<b>Hoselitz</b>	Group	Culturally marginal groups	Gaining social recognition.

8. K. Sadhak found that monetary consideration was the most important motivating factor. Entrepreneurs motivated by income were mainly traders and salaried employees. Independent job was as the main inspiration for salaried employees who were not satisfied with the' work environment, nature of job, management style, etc. Self-advancement, social recognition, responsibility were other motivating factors.

It is not only the desire to achieve but the favorable environment which translate the desire into reality. The above motivational factors were significantly influenced by certain assisting factors like family environment (business family), technical knowledge (through education or past employment); training and Government incentives. Entrepreneurs from business families enjoyed financial support, former employees had social contact, and engineers were having technical competence. It was, therefore, difficult to single out any particular motivating factor. However, income, social recognition and other 'pull' factors strongly induced people to start industry. Moreover, most of the entrepreneurs were, self-motivated. There were some stray cases also induced by varied factors like advice of business friends, the fabulous profits earned by others in similar concerns, contact it others, etc.

An entrepreneur is an agent who has, to perform several functions to mobilize and utilize resources and to create market. He ventures into an uncertain future to exploit the potentiality that exists. Therefore, entrepreneurship is a very risky proposition. Some people leave very cozy jobs to start their own enterprises. Some merchants, who are earning, well put their hard-earned money at stake in manufacturing. Technologists and engineers start their own industry instead of going for safe jobs. All these persons have high achievement motivation. 'Like all achievement oriented people, they want to take personal responsibility, tend to persist in the face of a adversity, tend to take moderate risks and like to know the results of their efforts. They are innovative and fall of interpersonal competence. According to McClelland, they are unusually creative, having high propensity of risk-taking capacity and a strong need for achievement.



Now, it is crystal clear from the foregoing analysis that the majority of entrepreneurs are motivated to enter industry mainly because of four- factors;

*First*, they possessed technical knowledge or manufacturing experience in the same or related line.

*Second*, there was heavy demand for the particular product.

*Third*, the Governmental and institutional assistance available facilitated, individuals to enter industry.

*Fourth*, they have enterprising attitude, what McClelland designate ‘an achievement motive’, to do something independent in life.

At the end of this lesson, Appendix-A gives a quiz to test your entrepreneurial motivation.

**4.3.4 Achievement Motivation-**David McClelland has developed an Achievement Motivation Theory. According to this theory an individual’s Need for achievement (n-Ach) refers to the need for personal accomplishment. It is the drive to excel, to strive for success and to achieve in relations to a set of standards. People with high achievement motive like to take calculated risks and want to win. They like to take personal responsibility for solving problems and want to know how well they are doing. High achievers are not motivated by money *per se* but instead employ money as a method of keeping sure of their achievements. Such people strive for personal achievement rather than the rewards of success. They want to do something better and more efficiently than it has been done before.

Need for achievement is simply the desire to do well not so much for the, sake of social recognition or prestige but for the sake of an inner feeling of personal of accomplishment. It is this need for achievement that motivates people to take risk. People with high need for achievement behave in an entrepreneurial way. Need for achievement stimulates the behavior of a person to be an entrepreneur.

The following psychological factors contribute to entrepreneurial motivation:

- Need for achievement through self-study, goal-setting and interpersonal, support.
- Keen interest in situations involving moderate risk.
- Desire for taking personal responsibility.
- Concrete measures of task performance.
- Anticipation of future possibilities.
- Energetic or novel instrumental activity.



- Organizational skills, etc.

Some societies produce a larger percentage of people with high need achievement. Entrepreneurship becomes the link between need achievement and economic growth. McClelland considers the need for achievement to be most critical to a nation's economic development. He held that a strong 'inner-spirit' in individuals to attain is a measurable variable arising from a need, which the individual develops mainly in childhood and seeks to satisfy throughout his life. This 'inner spirit' which he called need for achievement, if higher, would produce more energetic entrepreneurs capable of generating rapid economic development. High need for achievement or ambition motivates entrepreneurs to take risks, work hard, find new things, save more, and reinvest the savings in industry and so on. The limited empirical evidence of Durand supports the hypothesis that need for achievement contributes to entrepreneurial success.

McClelland rated the achievement motivation of different countries on the basis of ideas related to need for achievement contained in the children's stories. This has come to be known as n- factor rating. He established a correlation between n-factor rating and the prosperity of the countries a generation ahead. The criterion of n-factor rating was the inherent concern for achievement or the non-induced achievement motivation.

McClelland found that achievement motivation was lower among people of underdeveloped countries than among those of developed nations. Even in USA only about ten per cent of the people were actually high achievers. It is the low level of aspirations or ambitions that explains the lack of enterprise in under developed countries. Ambition is the lever of all motives and aimless life is a goalless game. Ambitions motivate men, activate them, broaden their vision and make life meaningful. Ambition is an index of one's resourcefulness. The ambition builds up a achievement pressure in the individual and provides the basis for McClelland's n factor. Ambition is the lever of all motives. The initiative and intentions of an individual are directed by his ambitions. It is the ambition that electrifies man's actions. Therefore, what matters is not merely the people but their aspirations and the means to achieve the goals. Therefore, it is the duty of leaders and teachers to build up ambition into the minds of the young people. However, ambitions differ from greed and windfall. Greed results in disaster and windfall makes one a speculator. Sometimes personal ambitions may come in the way of family aspirations or national aspirations. Unfulfilled ambitions are passed on to the next generation who may chase the goal



with redoubled effort and vigor. Thus ambition nourishes-the achievement motivation and brings economic growth. The biggest obstacle to economic progress in countries like India is perhaps the limited ambition of people. The initiative of an individual is directed by his ambitions which nourish the entrepreneurial spirit and bring about economic development. Hence what matters is not merely the people and their talents but their aspirations. However, ambitions differ among individuals on the basis of the environment in which they are born and brought up. J.K. Galbraith has also attributed the backwardness of man Asian and African countries to lack of ambition.

- **The Kakinada Experiment**-Assuming need for achievement plays a vital role in promoting economic growth, McClelland has tried to induce achievement motivation in adult and provide them with an urge to improve their lot because uninduced achievement motivation results in long waiting before it bears fruit. Such an inducement may help break the barrier of “limited aspirations”. For this purpose, he conducted experiments with groups of businessmen in America, Mexico and Bombay. Later he carried out a full-fledged programme in the Kakinada city of Andhra Pradesh.

Kakinada is a well-developed distinct town of a population of around one lakh with high literacy and a modest industrial structure. The objective of the programme was to break the barrier of “limited aspirations” by inducing achievement motivation. The project which began in January 1964 consisted of recruiting batches of personnel drawn from business and industrial community of this town and putting them through orientation programme at the Small Industry Extension Training (SIET) institute, Hyderabad. Fifty two persons grouped into three batches participated” in the programme. The training was designed primarily to stimulate the imagination and encourage introspection into personal motivation and community goals. The achievement development course contained four main items:

- The individuals strived to attain concrete and frequent feedback.
- The participants sought models of achievement i.e. watched those who have performed well and tried to emulate.
- The participants imagined themselves in need of success and challenge and set carefully planned and realistic work goals.
- The trainees were asked to control day dreaming by thinking and talk to themselves-in positive terms.



After two years those who had taken the course except for one Mexican case performed better than comparable men who did not take the course. The former made more money, got promoted faster and expanded business faster. In order to assess need for achievement, McClelland used the Thematic Appreciation Test (TAT) which presents the subject with an ambiguous picture. The individual is asked to interest what he sees and what is happening in the picture. Achievement related themes are then counted and the final score represents the individual's desire for high achievement.

About the results of the Kakinada experiment, McClelland concluded that those participating in the programme displayed more active business behaviour (51 per cent as against 25 per cent in the control group) and worked longer hours.

Significantly he found that caste, traditional beliefs or western ways of life did not determine the mental makeup of a participant. The training as was given at Hyderabad is likely to improve those who have a great yearning to do something and have the opportunity to do so in their business framework.

The Kakinada experiment is being utilized in a number of experiment that have recently initiated technical personnel to set up new enterprise of their own. In Gujarat, various State agencies have combined to operate an Entrepreneurship Development Programme to help young people acquire the motivation necessary to become risk-takers. The Gujarat programme has been successful in persuading many persons to set up new enterprises in the small scale sector. It was found that the follow-up "package" assistance offered by the State agencies in Gujarat has been particularly instrumental in helping the participants to decide on the enterprise they wish to start. Similarly, in Andhra Pradesh, the Small Scale Industrial Development Corporation Ltd. (APSSIDC) has been assisting technically qualified persons to become entrepreneurs through orientation programmes of the SIET Institute. This is followed by specific assistance of providing developed land specially earmarked for such persons at nominal rates in the technocrats' industrial estates.

Based on the experiences in Gujarat and Andhra Pradesh, the Ministry of Industrial Development has recently formulated schemes of helping technical personnel to become entrepreneurs. This programme consists of three months programme at selected centers spread all over the country, followed by financial assistance in terms of a subsidy on the interest on advances taken by the entrepreneur from the commercial banks so that the net interest paid by the entrepreneur himself does not exceed five percent.



The programme is designed to enable a young person to know the real problems of setting up an enterprise, and to work out the feasibility report of his own project. During this period, he is also provided with opportunities to visit industrial establishments in his field of specialization. Careful screening of the participant is done by the Selection Committee with the State Director of Industries as its Chairman so that the programme would result in a sizable number of new enterprises. It is expected thousands of young person's will be provided with such training in the years to come.

Making people achievement oriented or inculcating in them need for achievement, is the objective of all such programmes. Thus, efforts are made through such programmes to spread ambition. Ambition is the mother of all motives. The intentions and the initiative of the man are directed by his ambitions. It is they ambition that electrifies man's actions. The common saying aimless life is a goalless game - emphasis the importance of ambition in life. So, what matters most are not merely the men but their aspiration and what they do to reach their goal. It is the duty of the parents, the teachers and the leaders of the nation to instill ambition into the minds of the people. Naturally, ambitions differ from individual to individual on the basis of personal tastes and temperaments, and family to family and nation to nation depending upon the circumstances in which they are placed and the priorities which they have set for themselves. Sometimes, personal aspirations come in the way of family aspirations or national aspirations. Whoever it may be, aspirations do change with the changing times and values. For any man it may not be possible to cherish all his aspirations in his lifetime. So also a nation may not be able to fulfill all her ambitions within a span of 100 or 200 years. But the ambitions or aspirations which are unfulfilled are passed on to the next generation who may chase the target with redoubled effort and vigor. So, ambition which nourishes the achievements motivation brings in economic growth brings in development not merely in anyone segment of the economy but it results in total growth.

#### **4.4 Check Your Progress**

- 1) Which one of the following is need as described by Maslow?
  - (a) Basic Physiological Needs
  - (b) Safety Needs
  - (c) Social Needs
  - (d) All of the above



- 2) Need Hierarchy theory was given by.....?
  - (a) Weber
  - (b) David McClelland
  - (c) David P. Boyd
  - (d) Maslow
- 3) The term “Motivation” has come from which word?
  - (a) Move
  - (b) Moore
  - (c) Movere
  - (d) All of the above
- 4) Who one of the followings is the source of motivation as per Weber?
  - (a) Religious beliefs, Calvinist ethic
  - (b) Child-rearing practices and climate
  - (c) Innate urge to achieve success
  - (d) None of the above
- 5) Who used Thematic Appreciation Test (TAT) to assess need for achievement?
  - (a) Maslow
  - (b) McClelland
  - (c) Kunkel
  - (d) None of the above
- 6) Need Achievement theory was given by.....?
  - (a) Weber
  - (b) David McClelland
  - (c) David P. Boyd
  - (d) Schumpeter

## 4.5 Summary

An entrepreneur is a creative person. Need for self-actualization as manifested in the need for achieving forces him to create something new- a new product, a new way of doing things, a new source of raw material, a new market etc. Whenever a person feels any need, he feels uneasy and tension starts





building his mind. This tension provides him to initiate some action which may lead to satisfaction of the need. If that need is not satisfied that individual is required to resort to some alternative action for the satisfaction of the need. Motivation may be defined as the process that provokes a person into action and induces him to follow the course of action till the goals are finally achieved. Various theories to motivation are more relevant to entrepreneurship.

Prof A. H. Maslow developed a theoretical framework for understanding human motivation which has been widely acclaimed. According to him, a person's effectiveness is a function of matching his opportunity with the appropriate position of hierarchy of needs. Process of motivation begins with an assumption that behavior, at least in part, is directed towards the satisfaction of needs. Each person tends to develop certain motivational drives as a result of his cognitive pattern and the environment in which he lives. David McClelland gave a model of motivation which is based on three types of needs, namely, achievement, power and affiliation. According to this theory an individual's Need for achievement (n-Ach) refers to the need for personal accomplishment. It is the drive to excel, to strive for success and to achieve in relations to a set of standards. People with high achievement motive like to take calculated risks and want to win. Assuming need for achievement plays a vital role in promoting economic growth, McClelland has tried to induce achievement motivation in adult and provide them with an urge to improve their lot because uninduced achievement motivation results in long waiting before it bears fruit. Such an inducement may help break the barrier of "limited aspirations".

#### 4.6 Keywords

- **Motivation:** It is related with inner state of mind that activates and directs individual behavior towards a particular goal.
- **Incentive:** It is something which incites or tends to incite towards some determination.
- **Psychological Needs:** These include the needs for element that ensure basic survival like food, clothing and housing facilities.
- **Esteem Needs:** These needs are related with self-respect and personal recognition.
- **Need for Power:** It is related with the desire to influence or to control others.
- **Need for Achievement:** It is the desire to reach goals, to tackle challenges and to excel.
- **Monetary Incentives:** Motivation through monetary items like salary, bonus, commission etc.



- **Non-Monetary Incentives:** Motivation through non-monetary items like promotion, recognition, perquisites etc.
- **Need Hierarchy Theory:** Prof A. H. Maslow developed this theory. According to him, a person's effectiveness is a function of matching his opportunity with the appropriate position of hierarchy of needs.
- **Needs Achievement Theory:** David McClelland gave this theory. According to this theory an individual's Need for achievement (n-Ach) refers to the need for personal accomplishment.
- **Thematic Appreciation Test (TAT):** McClelland used this test in order to assess need for achievement of individuals.

#### 4.7 Self-Assessment Test

- What is meant by entrepreneurial motivation? Is it necessary for a successful entrepreneur? Discuss.
- What are the factors that motivate people to go into business?
- What do you understand by achievement motivation? How can achievement motivation be developed?
- Write an explanatory note on 'Kakinada Experiment' on achievement motivation.
- It is said that ambition is the lever of all motives. Do you agree? Comment.
- Explain the factors which prompt people to become entrepreneur.

#### 4.8 Answers to check your progress

- 1(d), 2 (d), 3(c), 4 (a), 5(b), 6 (b)

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### APPENDIX-A

#### TESTING ENTREPRENEURIAL MOTIVATION

Everybody cannot be trained to become an entrepreneur. Persons having a minimum level of latent qualities can be more successfully groomed as entrepreneurs. It becomes, therefore, necessary to judge the latent potential of would be entrepreneurs. Given below is a quiz to test entrepreneurial motivation. You can test your likelihood of becoming a successful entrepreneur by ticking the answer that is a true indicator of your personality. Then' check your responses with the scores and the rating given here.

1. I try to take charge of matters when I am with people  
A Always C Sometimes  
B Usually D Never
2. I press myself to meet deadlines  
A Always C Sometimes  
B Usually D Never
3. I dislike taking orders from others  
A Always C Sometimes  
B Usually D Never
4. I strike to make my subordinates content  
A Always C Sometimes  
B Usually D Never



5. Given the odds, I can influence the outcome of a situation
 

A Always	C Sometimes
B Usually	D Never
6. I am called upon to lead projects or teams
 

A Always	C Sometimes
B Usually	D Never
7. I enjoy the challenge of being faced with a complex task
 

A Always	C Sometimes
B Usually	D Never
8. I doggedly see projects through to their conclusion
 

A Always	C Sometimes
B Usually	D Never
9. I achieve anything I set my mind on
 

A Always	C Sometimes
B Usually	D Never
10. Others say I have a sharp, analytical mind
 

A Always	C Sometimes
B Usually	D Never
11. Things that typically unnerve most people don't ruffle me
 

A I strongly agree	C I strongly disagree
B I moderately agree	D I moderately disagree
12. I seem to have much high energy level than most people



- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
13. I believe things cannot be rushed
- A I strongly agree.                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
14. I would fire a subordinate even if disliked the task
- A I strongly agree                      C I strongly disagree
- B I moderately disagree                      D I moderately agree
15. I would start a business even if it meant tightening my belt
- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
16. I will never balk from working long hours for lengthy periods
- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
17. I have a high tolerance level and am not easily frustrated
- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
18. I get bored easily with routine tasks and thrive on challenges
- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
19. It is important for me to be the best in whatever I do
- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree



20. I don't mind working for a difficult person if he is competent
- A I strongly agree                      C I strongly disagree
- B I moderately agree                      D I moderately disagree
21. I fall in the following age bracket
- A Between 20 and 28 years                      C Between 38 and 46 years
- B Between 29 and 37 years                      D Over 47 years
22. My experience in the industry I would start a business is
- A More than two years                      C Between six and 12 months
- B Between 12 and 24 months                      D Nil
23. In the past three years, due to illness I have lost
- A 0-5 days of work                      C 11-15 days of work
- B 6-10 days of work                      D Above 16 days of work
24. I need the following amount of sleep to function effectively
- A 5 or less hours                      C 7 hours
- B 6 hours                      D 8 hours

### THE SCORES

1	A:5;	B:3;	C:1;	D:0
2	A:5;	B:3;	C:1;	D:0
3	A:5;	B:3;	C:1;	D:0
4	A:5;	B:3;	C:1;	D:0
5	A:5;	B:3;	C:1;	D:0
6	A:5;	B:3;	C:1;	D:0
7	A:5;	B:3;	C:1;	D:0



8	A:5;	B:3;	C:1;	D:0
9	A:5;	B:3;	C:1;	D:0
10	A:5;	B:3;	C:1;	D:0
11	A:5;	B:3;	C:1;	D:0
12	A:5;	B:3;	C:1;	D:0
13	A:5;	B:3;	C:1;	D:0
14	A:5;	B:3;	C:1;	D:0
15	A:5;	B:3;	C:1;	D:0
16	A:5;	B:3;	C:1;	D:0
17	A:5;	B:3;	C:1;	D:0
18	A:5;	B:3;	C:1;	D:0
19	A:5;	B:3;	C:1;	D:0
20	A:5;	B:3;	C:1;	D:0
21	A:5;	B:3;	C:1;	D:0
22	A:5;	B:3;	C:1;	D:0
23	A:5;	B:3;	C:1;	D:0
24	A:5;	B:3;	C:1;	D:0

**TOTAL****THE RATING****0-32 Points**

**The Drone.** Forget about launching a start-up; your work and life tendencies indicate that you are destined to remain a worker bee until you retire. But be warned: your distinct lack of initiative could hamper your career growth.

**33-95 Points**

**The intrapreneur.** While you exhibit entrepreneurial traits, you still don't quite make the grade. But don't be disheartened. As corporate demand more entrepreneurial skills from their employees, you will have a chance of showing your true mettle.

**96-120 Points.**

**The Entrepreneur.** How come you're still making money for someone else? You've certainly got what it takes to takes the plunge, so don't waste time. After all, post-liberalization India offers the best opportunity yet to get to where the buck stops.





<b>Subject:</b> Entrepreneurship Development	
<b>Course Code:</b> BCOM 405	<b>Author:</b> Prof. M. C. Garg
<b>Lesson No.:</b> 05	<b>Updated By:</b> Mr. Kapil Singh
<b>METHOD AND PROCEDURES TO START AND EXPAND ONE'S OWN BUSINESS STRUCTURE</b>	

## Structure

- 5.0 Learning Objectives
- 5.1 Introduction
- 5.2 Various Forms of Business Organizations
  - 5.2.1 Sole proprietorship
  - 5.2.2 Partnership
  - 5.2.3 Joint Stock Company
  - 5.2.4 Co-operative Society
- 5.3 Choice of a Suitable Form of Business Organization
- 5.4 Check Your Progress
- 5.5 Summary
- 5.6 Keywords
- 5.7 Self-Assessment Test
- 5.8 Answers to check your progress
- 5.9 References/Suggested Reading

## 5.0 Learning Objectives

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



- Discuss the features, advantages and disadvantages of sole proprietorship.
- Enlist the advantages and disadvantages of partnership.
- Bring out the salient features of company and explain the circumstances of suitability of private company.
- Explain the merits and demerits of company form of business organization.
- Describe the features, advantages and disadvantages of cooperative society.
- Examine the factors which help the entrepreneur in making final choice for a suitable form of organization.

## **5.1 Introduction**

Choice of a proper form of organization is crucial for the success of a business enterprise. Every entrepreneur has to decide, at the outset, the type of ownership organization in which his enterprise is to be run. Choice of form of business organization is crucial because it determines the risk, responsibility and control of the entrepreneur as well as the division of profits. It is a long-term decision because the form of organization cannot be changed frequently. The right form of organization can help the enterprise not only through initial success but in later growth too. Therefore, the form of ownership organization should be selected after due care and thought. A business enterprise can be owned and organized in several forms. These forms of business organization are as under:

- Sole Proprietorship
- Partnership firm
- Joint Stock Company and
- Cooperative society

Every form has its own merits and demerits. Therefore, a businessman is faced with the problem of selecting a suitable form of ownership for his business. This problem arises not only at the time of launching a new business enterprise but also at the time of expansion or growth in the size of business.

### **5.2.1 Sole Proprietorship**

Sole proprietorship (also, called sole trade organization) is the oldest form of business ownership in India. In a sole proprietorship, the enterprise is owned and controlled by one person. He is master of his



show. He sows, reaps and harvests the output of this effort. He manages the business on his own. If necessary, he may take the help of his family members, relatives and employ some employees.

Sole proprietorship is the simple and easiest to form. It does not require legal recognition and attendant formalities. This form is the most popular form in India due to the distinct advantages it offers. William R. Basset opines that “The one-man control is the best in the world if that man is big enough to manage everything”.

The important features of a sole proprietorship are:

- Sole ownership
- One man control
- Unlimited risk
- Undivided risk
- No separate entity of the firm
- No Government regulation

### Advantages of Sole Proprietorship

Following are the advantages of sole proprietorship:

- **Easy and Simple Formation:** A sole trading concern can be formed without any difficulty. Unlike other forms, no legal formalities are necessary for its formation. It can be started and can also be closed according to wishes and whims of the sole trader. Thus, there are no legal formalities for expansion, contraction or dissolution of the business enterprise.
- **Direct and Exclusive Control:** The proprietor has full authority to manage the business. He is not accountable to anyone and nobody interferes in his working. Thus, there is no problem of co-ordination; he is in a better position to maintain good relations with all his employees, if any.
- **Promptness in Decision-making:** The sole trader is the sole dictator of the business and relatively free from outside interference. He is capable of taking prompt action so necessary for business success.
- **Direct Motivation and Incentive to Work:** The owner enjoys the entire profits of the concern alone. The existence of the direct relationship between the effort and the reward serves as a



powerful incentive and makes the sole trader work very hard and manage his concern most efficiently.

- **Maintenance of Secrecy:** In any business enterprise, maintenance of business secrecy is an important factor; and it is in this individual entrepreneurial organization that the sole trader will get this object fulfilled as there is no need to give publicity to accounts and affairs of his business.
- **Personal Touch with Customers:** As the enterprise is generally small and most often the proprietor himself manages it, he can develop close personal relations with his customers. This promotes customer satisfaction which, subsequently, adds to goodwill of the concern.
- **Economy in Management:** The business of sole proprietorship is mostly supervised, managed and controlled by the sole proprietor alone or with the help of his relatives and friends and sometimes by one or two paid assistant; hence the costs of management are comparatively lower.
- **Minimum Government Regulation:** The operations of a sole proprietor are regulated by Government and law to the minimum extent. He of course, has to comply with tax and Labour laws, but otherwise he is free from interference. There are no legal formalities in formation, expansion or dissolution of the business enterprise.
- **Socially Significant:** Sole proprietorship is important from social point of view also. It is a means for earning livelihood independently. The owner is his own master. It ensures diffusion of business ownership and, thus, concentration of wealth and power in a few hands is avoided. It further, helps in the development entrepreneurial qualities such as self-reliance, self-confidence, responsibility, tact and initiative etc. in the individual entrepreneurs.

### Disadvantages of Sole Proprietorship

Following are the disadvantages of sole proprietorship:

- **Limited Financial Resources:** A single individual normally does not possess enough capital. His borrowing capacity is also limited. Therefore, a sole proprietorship firm suffers from lack of financial resources. Consequently, it has to confine its activities within a limited range.
- **Limited Managerial Ability:** The limitation of managerial ability is as glaring as that of capital. An individual, however, capable and qualified may be cannot manage all functions of the business. He is not supposed to possess knowledge of all the functional areas of the business. Moreover,



because of the small size of the business and limited financial resources available to him, he may not be in a position to appoint expert managers. Thus, in the modern competitive world of business where different aspects are managed by experts, sole proprietors concern likely to suffer from stagnation in the absence required managerial ability.

- **Unlimited Liability:** The unlimited liability of the single proprietor is a great disadvantage to him; because business debts run against his entire property and not merely against the amount invested in the business. This discourages the risk-taking instinct of the entrepreneur.
- **Uncertainty of continuity:** Continuity of the sole proprietors business is difficult to maintain. When the proprietor dies there is no guarantee for the continuity of the business; because there is no legal obligation to continue the same concern. The legal heir of the proprietor may lack requisite qualities or may not have any liking for the same business. With the result, the business may come to an end. There is also no legal obligation that once a business is started, it must be continued under any circumstances. Thus, the continuity of the business solely depends on the sole proprietor and his legal heir.
- **Diseconomies of Small Size:** A small scale firm cannot economies in purchase, production and marketing. In a sole trader's concern, overhead cost is also more. Thus, a sole proprietorship firm suffers from diseconomies of small scale and is not in a position to compete with the large-scale organizations having economies of large-scale.
- **Limited Growth:** Growth is a normal rule of life. A business firm is bound to grow in size; as it is a living organism. Practically, due to the limitations of capital and managerial ability as discussed above, the growth of the sole trader's business is affected adversely; it is never in a position to bloom fully.

**Suitability-**The foregoing description reveals that sole proprietorship or one man control is the best in the world if that man is big enough to manage everything. But such a person does not exist. Therefore, sole proprietorship is suitable in the following cases:

- Where small amount of capital is required, e.g., sweet shops, bakery, newsstand, etc.
- Where quick decisions are very important, e.g., share brokers, bullion dealers, etc.
- Where limited risk is involved, e.g., automobile repair shop, confectionery, small retail store, etc.



- Where personal attention to individual ‘tastes and fashions of customers is required, e.g., beauty parlor, tailoring shops, lawyers, painters, etc.
- Where the demand is local, seasonal or temporary, e.g., retail trade, laundry, fruits sellers, etc.
- Where fashions change quickly, e.g., artistic furniture, etc.
- Where the operation is simple and does not require skilled management.

Thus, sole proprietorship is a common form of organization in retail trade, professional firms, household and personal services. This form of organization is quite popular in our country. It accounts for the largest number of business establishments in India, in spite of its limitations.

### **5.2.2 Partnership**

The need for partnership firm form of organization arose from the limitations of sole proprietorship. With the expansion of business, it became necessary for a group of persons to join hands together and supply necessary capital and skill. A person may possess exceptional business ability but no capital; he can have a financing partner. A financier may need a managerial expert as well as a technical expert and all of them may combine to set up a business with common ownership and management. Thus, partnership organization has grown out of necessity to arrange more capital; provide better management and control, to take advantage of high degree of specialization and division of labour, and to share the risks.

Section 4 of the Indian Partnership Act of 1932 defines partnership as “the relation between persons who have agreed to share profits of a business carried on by all or any of them acting for all”. Owners of the partnership business are individually called “partners” and collectively called a “firm”. The name under which the business is carried on is known as “firm name”. The terms and conditions of partnership are contained in the partnership agreement known as “Partnership Deed”.

### **Main Features**

Based on the above discussion, we can now list the main features of partnership form of business ownership/organization in a more orderly manner as follows:



- **More Persons:** As against sole proprietorship, there should be at least two persons subject to a maximum of ten persons for banking business and twenty for non-banking business to form a partnership firm.
- **Profit and Loss Sharing:** There is an agreement among the partners to share the profits earned and losses incurred in partnership business.
- **Contractual Relationship:** Partnership is formed by an agreement – oral or written - among the partners.
- **Existence of Lawful Business:** Partnership is formed to carry on some lawful business and share its profits or losses. If the purpose is to carry some charitable works, for example, it is not regarded as partnership.
- **Utmost Good Faith and Honesty:** A partnership business solely rests on utmost good faith and trust among the partners.
- **Unlimited Liability:** Like sole proprietorship, each partner has unlimited liability in the firm. This means that if the assets of the partnership firm fall short to meet the firm's obligations, the partner's private assets will also be used for the purpose.
- **Restrictions on Transfer of Share:** No partner can transfer his share to any outside person without seeking the consent of all other partners.
- **Principal-Agent Relationship:** The partnership firm may be carried on by all partners or any of them acting for all. While dealing with firm's transactions, each partner is entitled to represent the firm and other partners. In this way, a partner is an agent of the firm and of the other partners.

### Advantages of Partnership

The advantages of partnership are as follows:

- **Easy Formation:** Formation of partnership is easier and no legal formalities are to be observed to establish it. At the same time, unlike a company not much of expenses are incurred for its formation. However, as compared to sole trader's concern, it may involve certain difficulties, especially in selection and organization of partners, etc.
- **Larger Financial Resources:** In a partnership, since several persons pool their financial resources into a common business, the amount of capital accumulation becomes much higher than what can



be contributed by one person in sole trader's concern. The scale of operations can be enlarged to reap the economies of scale. There is always scope for the introduction of new partners to augment resources.

- **Flexibility:** It's a highly flexible organization. Changes can be introduced easily. The necessary additional capital can be raised; new partners can be introduced, the place and object of the firm can be changed. Business of the firm can also be expanded or contracted according to the requirements of the business.
- **Combined Abilities and Balanced Judgment:** In a partnership firm, better management of the business is ensured because capital and brain of two or more persons are pooled. Combined abilities and balanced judgment produce appreciable results. Two heads are better than one is an old saying.
- **Direct Motivation:** Since the partners themselves manage the business, they are likely to manage it with great care, caution and interest. Moreover, partnerships provide a fair correlation between rewards and efforts on the part of owners, and as such partners are motivated to apply the best of their energy and capacity for the success of the business.
- **Division of Risks:** In sole proprietorship, the risks of business are to be shouldered by one person alone; but in partnership, the risks are to be shared by all the partners. Thus, partnership is more useful for risky business.
- **Business Secrecy:** The annual accounts and reports of a partnership firm do not require circulation and publicity and, therefore, secrecy can be maintained about the business.
- **Protection of Minority Interest:** The Partnership Act provides equal rights and powers for all the partners irrespective of their capital contributions. Every partner has a right to participate in the management of the business. All important decisions are to be taken by the consent of all the partners. If a majority decision is enforced on minority, affected partners can get the business dissolved.
- **Encouragement of Mutual Trust and Interdependence:** Each partner is an agent for the others. Therefore, all the partners act with utmost mutual trust. They also develop a sense of interdependence and team spirit. At the same time each partner develops his individuality through his responsibility for others and the firm as a whole.





- **Easy Dissolution:** A partnership firm can easily be dissolved. It is a kind of voluntary association for carrying on business operations. Therefore, it can be dissolved by the partners merely by expressing to each other their intention to do so. In the case of a partnership-at-will, it can be dissolved by giving 14 days' notice to other partners.

### Disadvantages of Partnership

The disadvantages of partnership are as follows:

- **Unlimited Liability:** The partners, like a sole proprietor but unlike shareholders of a joint stock company, may be personally held liable for the debts of the firm. Their private property also remains at stake. Due to the dangers associated with unlimited liability, partners are over-cautious and play safe. This restricts the expansion and growth of the business.
- **Limited resources:** There is an upper limit to the number of partners in a partnership firm - 20 in a general business and 10 in a banking business. Due to this, in spite of the pooling of the resources by all the partners, it becomes difficult for a partnership to manage the increasing requirements of capital and managerial skills of expanding business. This limitation limits the growth of business beyond ascertain size.
- **Instability:** A partnership firm suffers from the uncertainty of duration; because it can be dissolved at the time of death, lunacy or insolvency of a partner. Sometimes petty quarrels among the partners may also bring the partnership to an end. The discontinuity of the business is not only inconvenient to the consumers and workers but is also a social loss.
- **Non-Transferability of Interest:** Partners cannot transfer their interests in the partnership firm to outsiders without the consent of all other partners. This non-transferability is a drawback of the partnership firm and dissuades many persons from investment in such a firm. On the other hand, shares of a joint stock company are easily transferable and, thus, provide liquidity to the investment.
- **Lack of Public Confidence:** Since there is no publicity of the working of a partnership through its published periodical accounts and there is absence of legal control over it, the general public may not have full confidence in them.



- **Risk of Implied Authority:** A partner, being an agent of the firm and his co-partners, can make deals and contracts that would be binding on other partners. Therefore, when a partner is negligent or commits a wrong or is guilty of a fraud, within the scope of his authority, other partners are equally liable financially without any limit. Thus, the honest and efficient partner may have to pay the penalty for follies and vices of other partners.
- **Lack of Centralized Authority:** The power of management is vested in all the partners; there is absence of a supreme and central authority. Consequently, many problems crop up, particularly when there is absence of mutual understanding and co-operation. Constant opposites and disagreements on the part of partners hamper the growth of the partnership business at every stage and, ultimately, may even put an end to the existence of the partnership, after a short span of life.

### Partnership Deed

By now, you have learnt that partnership is an agreement between persons to carry on a business. The agreement entered into between partners may be either oral or written. But, it is always desirable to have a written agreement so as to avoid misunderstandings and unnecessary litigations in future. When the agreement is in written form, it is called 'Partnership Deed'. It must be duly signed by the partners, stamped and registered. Any alteration in partnership deed can be made with the mutual consent of all the partners.

Although it is left to the choice of the partners of the firm to decide themselves as to what should be mentioned in their partnership deed, yet a partnership deed generally contains the following:

- Name of the firm
- Nature of the business
- Names of the partners
- Place of the business
- Amount of capital to be contributed by each partner
- Profit sharing ratio between the partners.
- Loans and advances from the partners and the rate of interest thereon.
- Drawings allowed to the partners and the rate of interest thereon.
- Amount of salary and commission, if any payable to the partners.



- Duties, powers and obligations of partners.
- Maintenance of accounts and arrangement for their audit.
- Mode of valuation of goodwill in the event of admission, retirement and death of a partner.
- Settlement of accounts in the case of dissolution of the firm.
- Arbitration in case of disputes among the partners.
- Arrangements in case partner become involvement.

### Registration of the Firm

Under the Indian Partnership Act, 1932, the registration of the firm is not compulsory. An unregistered firm suffers from certain limitations, hence the registration of the firm is desirable. Registration can be done at any time. The procedure for registration is as follows:

The firm will have to apply to the Registrar of Firms of the respective State Government in a prescribed application form. The form should be duly signed by all the partners. The application form should contain the following information:

- The firm-name.
- The name of business place.
- Names of other places, if any, where the firm is carrying on its business.
- Date of commencement of business.
- Date when each partner joined the firm.
- Full names and permanent addresses of all the partners.
- The duration of the firm, if any.

When the Registrar of Firms is satisfied that all formalities relating to registration have been fully complied with, he makes an entry in Register of Firms. Thus, the firm is considered to be registered. The Register of Firm remains open for inspection on payment of prescribed fee for the purpose.

### Dissolution of Firm

There is a difference between the dissolution of partnership and dissolution of firm. Dissolution of partnership occurs when a partner ceases to be associated with the business, whereas dissolution of firm is the winding up the business. In other words, in case of dissolution of partnership, the business of the



firm does not come to an end but there is a new agreement between the remaining partners. But in case of dissolution of firm, the business of the firm is closed up. In brief, dissolution of partnership does not imply the dissolution of firm. But, dissolution of firm implies dissolution of partnership also. Following are the various ways in which a firm may be dissolved:

**1. Dissolution by Agreement:** The partnership firm may be dissolved in accordance with a contract already made between the partners.

**2. Compulsory Dissolution:** A firm stands compulsorily dissolved under the following circumstances:

- By the adjudication of all the partners or of all the partners but one as insolvent, or
- By the happening, of any such event that makes the business unlawful.

**3. Dissolution due to Contingencies:** A firm stands dissolved on the happening of the any of the following contingencies:

- On expiry of partnership period, if constituted for a fixed period.
- On completion of the firm's venture for which the firm was formed.
- On the death of a partner.
- On the adjudication of a partner as an insolvent.

**4. Dissolution by Court:** Under any of the following cases, a court may order the dissolution of a firm:

- Any partner has become of unsound mind.
- Any partner has become permanently incapable of performing his duties as a partner.
- A partner's misconduct is likely to affect prejudicially the business of the firm.
- A partner's misconduct is likely to affect prejudicially the business of the firm.
- A partner transfers his interest in the firm, but unauthorized to a third party.
- The business of the firm can be carried on at loss only.
- It is just and equitable, on the basis of any other reasonable ground, that the firm should be dissolved.

### Settlement of Accounts on Dissolution



Settlement of accounts means closure of all accounts in the-books of the firm as the firm's business no longer exists. According to Section 48 of the Indian Partnership Act, 1932, the procedure for the settlement of accounts after the dissolution of the firm is as follows:

The assets of the firm are disposed of and the amounts so realized are applied in the following manner:

- Payment of debts due to the third parties.
- Ratable payment of loans and advances made by the partners to the firm
- Payment of partners' capital
- Payment of surplus, if any, to the partners in their profit sharing ratio.
- The losses of the firm on dissolution have to be made up:
  - First out of accumulated pass profits.
  - Then, out of capitals of partners.
  - Thereafter, out of contributions from the private estates of the partners in their profit sharing ratios.

It is important to mention that the private property of the partner is to be used first to pay his private debts and only the surplus, if any, can be used to pay firm's liabilities. Similarly, firm's assets are first used to pay firm's liabilities. Only surplus can be used to pay the partner's private liabilities.

**Suitability:** The foregoing description reveals that partnership form of organization is appropriate for medium-sized business that requires limited capital, pooling of skill and judgment and moderate risks, like small scale industries, wholesale and retail trade, and small service concerns like transport agencies, real estate brokers, professional firms like chartered accountants, doctor's clinic or nursing homes, attorneys, etc.

### 5.2.3 Joint Stock Company

With the enlargement of the scale of business operations, it became difficult for a sole proprietorship or partnership firm to cope with the problems of finding additional resources and arranging for more specialized management. In addition to this, the unlimited liability of the sole trader and partners also hindered the business in several ways. Apart from these limitations, the introduction of advanced technologies, economies of large-scale production and other developments in the field of industry and commerce forced businessmen to think "in terms of bigger forms of organization. The sole



proprietorship and partnership failed to face the challenge posed by these developments. As a result, the present form of the joint stock companies emerged. It was found the most suitable form of organization for large scale production. A joint stock company not only helped in overcoming the limitations of sole proprietorship and partnership but also placed huge amount of capital in the hands of entrepreneur and that too with limited liability. It provided an opportunity for every person, rich or poor, to contribute to its capital.

A company may be defined as a voluntary association of persons, recognized by law, having a distinctive name, a common seal formed to carry on, business for profit with- capital divisible into transferable shares, limited liability, a corporate body and perpetual succession.

### Salient Features of a Company

The distinctive characteristics of a company are as follows:

- **Separate legal entity:** A company has an existing entirely distinct from and independent of its members. It can own property and enter into contracts in its own name. It can sue and be sued in its own name. There can be contracts and suits between a company and the individual members who compose it. The assets and liabilities of the company are not the assets and liabilities of the individual members and *vice versa*. No member can directly claim any ownership right in the assets of the company,
- **Artificial legal person:** A company is an artificial person created by law and existing only in contemplation of law. It is intangible and invisible having no body and no soul. It is an artificial person because it does not come into existence through natural birth and it does not possess the physical attributes of a natural person. Like a natural person, it has rights and obligations in terms of law. But it cannot do those acts which only a natural person can do, e.g., taking an oath in person, enjoying married life, going to jail, practicing profession, etc. A company is not a citizen as it enjoys no franchise or other fundamental rights.
- **Perpetual succession:** A company enjoys continuous or uninterrupted existence and its life is not affected by the death, insolvency, lunacy, etc. of its members, or directors. Members may come and go but the company survives so long as it is not wound up. Being a creature of law, a company can



be dissolved only through the legal process of winding up. It is like a river which retains its identity though the parts composing it continuously change.

- **Limited Liability:** Liability of the members of a limited company is limited to the value of the shares subscribed to or to the amount of a guarantee given by them. Unlimited companies are an exception rather than the general rule. In a limited company, members cannot be asked to pay anything more than what is due or unpaid on the shares held by them even if the assets of the company are insufficient to satisfy in full the claims of its creditors.
- **Common Seal:** A company being an artificial person cannot sign for itself. Therefore, the law provides for the use of common seal as a substitute for its signature. The common seal with the name of the company engraved on it serves as a token of the company's approval of documents. Any document bearing the common seal of the company and duly witnessed (signed) by at least two directors is legally binding on the company.
- **Transferability of shares:** The shares of a public limited company are freely transferable. They can be purchased and sold through the stock exchange. Every member is free to transfer his shares to anyone without the consent of other members.
- **Separation of ownership and management:** The number of members in a public company is generally very large so that all of them or most of them cannot take active part in the day-to-day management of the company. Therefore, they elect their representatives, known as directors, to manage the company on their behalf. Representative control is thus an important feature of a company.
- **Incorporated association of persons:** A company is an incorporated or registered association of persons. One person cannot constitute a company under the law. In a public company, at least seven persons and in a private company at least two persons are required.

### Private and Public Companies

- (i) Private Company: It is company which by its Articles of Association:
- restricts the right of its members to transfer shares, if any;
  - Limits the number of its members to so, excluding members who are or were in the employment of the company; and



- Prohibits any invitation to the public to subscribe for any shares in, or debentures of, the Company.

The minimum number of members required to form a private company is two. Such a company must use the word 'private' in its name. A private company enjoys special privileges and exemptions under the Companies Act. A public company is that company which is not a private company.

**Table 1 Distinction between Private and Public Companies**

Point of Distinction	Private Company	Public Company
<b>Number of Members</b>	Minimum – 2 Maximum – 50	Minimum – 7 Maximum – No limit
<b>Name</b>	The name must include the word 'Private Limited'.	The name must include the word "Limited".
<b>Number of directors</b>	Minimum – 2	Minimum – 3
<b>Articles of Association</b>	Must prepare its own Articles of Association.	May adopt Table A as given the Companies Act.
<b>Public Subscription</b>	Cannot invite public to subscribe to its shares and debentures.	Generally invites public to subscribe to its shares and debentures.
<b>Prospectus</b>	Need not issue and file a prospectus.	Must issue and file a prospectus or a statement in lieu of prospectus.
<b>Allotment of shares</b>	No restrictions on allotment of shares. No binding on further issue of shares. Complying with other legal formalities. Further issue of shares must in the first instance be offered to the existing.	Cannot allot shares without raising minimum subscription and without members.
<b>Commencement of Business</b>	Can commence its business	Can commence business only





	immediately after getting the Certificate of Incorporation.	after only after getting the Certificate of Commencement of Business.
<b>Transfer of shares</b>	Restrictions on transfer of shares	No restrictions on transfer of shares.
<b>Share Warrants</b>	Cannot issue share warrants.	Can issue share warrants per bearer.
<b>Statutory Meeting and report</b>	Not required to hold statutory meeting or file a statutory report.	Must hold a statutory meeting and file a statutory report.
<b>Deferred Shares</b>	Can issue deferred shares with disproportionate voting rights.	Cannot issue such shares.
<b>Directors</b>	(a) No Qualification shares	(a) Qualification shares prescribed.
	(b) Directors need not retire by rotation every year.	(b) One third of the two thirds of directors must retire by rotation every year.
	(c) No restriction on the appointment and reappointment of managing/ whole time directors.	(c) Appointment and reappointment requires Approval of the Central Government.
	(d) No limit on number of directorships.	(d) An individual cannot be a director of more than 20 companies.
	(e) Directors can borrow from their company.	(e) Directors cannot borrow without the approval of Central Government.
	(f) A director can occupy any office or profit.	(f) Special resolution required for this purpose.



	(g) Interested director can vote in the board meeting.	(g) Interested director cannot vote in the meeting.
<b>Managerial Remuneration</b>	No restriction on directors' remuneration.	Total annual remuneration must not exceed 11 per cent of the net profits. In case of insufficiency of profits, the maximum limit is Rs. 50,000 per annum.
<b>Index of Members</b>	Need not keeps at separate index of members.	If membership exceeds 50, a separate index of members is required.

### Suitability of Private Company

The above description reveals that a private company is a compromise between partnership and public company. To some extent, it combines the advantages of both. It enjoys the advantages of separate legal entity, continuity, limited liability and business secrecy. At the same time, it is free from excessive Government regulation and progressive income tax liability.

For these reasons, a private company is very suitable for organizing a medium-sized business involving considerable risk of loss or uncertainty of profit. Wholesale trade, large scale retailing, e.g., departmental stores, chain stores, etc., and transportation services are examples of such business. Private company is also preferred by those who wish to take the advantage of limited liability but at the same time desire to keep control over the business within a limited circle of friends and relatives and want to maintain the privacy of their business. A family can maintain secrecy of business, avoid the risk of unlimited liability and avail of the facility or ease of partnership. Due to the small number of members there can be high degree of privacy and there is comparative freedom from legal requirements. Private company organization is also appropriate in case of business of a speculative nature, e.g., hire purchase trading, stock-brokers, underwriting firms, etc. Another reason for the popularity of private company organization is several exemptions and privileges granted by law.

### Privileges of a Private Company



In spite of certain restrictions imposed on a private company, it enjoys certain privileges under the Companies Act. That is why a substantial number of entrepreneurs prefer to form a private company. Following are the important privileges granted to a private company:

- For forming a private company, only two members are required.
- A private Company is required to have only two directors.
- Such company is not required to file prospectus or a statement in lieu of prospectus with the Registrar of Companies.
- It can commence its business immediately after incorporation.
- It is also not required to hold a statutory meeting nor is it required to file a statutory report.
- The directors of a private company are not required to give their consent to act or to take up their qualification shares prior to their appointment.
- A non-member cannot inspect the copies of the Profit Loss A/c filed with the Registrar of Companies.
- Limit on payment of maximum managerial remuneration does not apply to a private company.
- Restrictions on appointment and reappointment of managing director does not apply to such company.
- A private company is not required to maintain an index of its membership.

### Merits of Company Organization

The company form of business ownership has become very popular in modern business on account of its several advantages:

- **Limited liability:** Shareholders of a company are liable only to the extent of the face value of shares held by them. Their private property cannot be attached to pay the debts of the company. Thus, the risk is limited and known. This encourages people to invest their money in corporate securities and, therefore, contributes to the growth of the company form of ownership.
- **Large financial resources:** Company form of ownership enables the collection of huge financial resources. The capital of a company is divided into shares of small denominations so that people with small means can also buy them. Benefits of limited liability, transferability of shares attract



investors. Different types of securities may be issued to attract various types of investors. There is no limit on the number of members in a public company.

- **Continuity:** A company enjoys uninterrupted business life. As a body corporate, it continues to exist even if all its members die or desert it. On account of its stable nature, a company is best suited for such types of business which require long periods of time to mature and develop.
- **Transferability of Shares:** A member of a public limited company can freely transfer his shares without the consent of other members. Shares of public companies are generally listed on a stock exchange so that people can easily buy and sell them. Facility of transfer of shares makes investment in company liquid and encourages investment of public savings into the corporate sector.
- **Professional management:** Due to its large financial resources and continuity, a company can avail of the services of expert professional managers. Employment of professional managers having managerial skills and little financial stake results in higher efficiency and more adventurous management. Benefits of specialization and bold management can be secured.
- **Scope for growth and expansion:** There is considerable scope for the expansion of business in a company. On account of its vast financial and managerial resources and limited liability, company form has immense potential for growth. With continuous expansion and growth, a company can reap various economies of large scale operations, which help to improve efficiency and reduce costs.
- **Public confidence:** A public company enjoys the confidence of public because its activities are regulated by the Government under the Companies Act. Its affairs are known to public through publication of accounts and reports. It can always keep itself in tune with the needs and aspirations of people through continuous research and development.
- **Diffused risk:** The risk of loss in a company is spread over large number of members. Therefore, the risk of an individual investor is reduced.
- **Social benefits:** The company organization helps to mobilize savings of the community and invest them in industry. It facilitates the growth of financial institutions and provides employment to a large number of persons. It provides huge revenues to the Government through direct and indirect taxes.

**Demerits of Company:** A company suffers from the following limitations:



- **Difficulty of formation:** It is very difficult and expensive to form a company. A number of documents have to be prepared and filed with the Registrar of Companies. Services of experts are required to prepare these documents. It is very time-consuming and inconvenient to obtain approvals and sanctions from different authorities for the establishment of a company. The time and cost involved in fulfilling legal formalities discourage many people from adopting the company form of ownership. It is also difficult to wind up a company.
- **Excessive Government control:** A company is subject to elaborate statutory regulations in its-day to day operations. It has to submit periodical reports. Audit and publication of accounts is obligatory. The objects and capital of the company can be changed only after fulfilling the prescribed legal formalities. These rules and regulations reduce the efficiency and flexibility of operations. A lot of precious time, effort and money has to be spent in complying with the innumerable legal formalities and irksome statutory regulations.
- **Lack of motivation and personal touch:** There is divorce between ownership and management in a large public company. The affairs of the company are managed by the professional and salaried managers who do not have personal involvement and stake in the company. Absentee ownership and impersonal management result in lack of initiative and responsibility. Incentive for hard work and efficiency is low. Personal contact with employees and customers is not possible.
- **Oligarchic management:** In theory the management of a company is supposed to be democratic but in actual practice company becomes an oligarchy (rule by a few). A company is managed by a small number of people who are able to perpetuate their reign year after year due to lack of interest, information and unity on the part of shareholders. The interests of small and minority shareholders are not well protected. They never get representation on the Board of Directors and feel oppressed.
- **Delay in decisions:** Too many levels of management in a company result in red-tape and bureaucracy. A lot of time is wasted in calling and holding meetings and in passing resolutions. It becomes difficult to take quick decisions and prompt action with the consequence that business opportunities may be lost.
- **Conflict of interests:** Company is the only form of business where in a permanent conflict of interests may exist. In proprietorship there is no scope for conflict and in a partnership continuous conflict results in dissolution of the firm. But in a company conflict may continue between



shareholders and board of directors or between shareholders and creditors or between management and workers.

- **Frauds in Promotion and Management:** There is a possibility that unscrupulous promoters may float company to dupe innocent and ignorant investors. They may collect huge sums of money and, later on, misappropriate the money for their personal benefit. The case of South Sea Bubble Company is the leading example of such malpractices by promoters. Moreover, the directors of a company may manipulate the prices of the company's shares and debentures on the stock exchange on the basis of inside information and accounting manipulations. This may result in reckless speculation in shares and even a sound company may be put into financial difficulties.
- **Lack of Secrecy:** Under the Companies Act, a company is required to disclose and publish a variety of information on its working. Wide spread publicity of affairs makes it almost impossible for the company to retain its business secrets. The accounts of a public company are open for inspection to public.
- **Disadvantageous from Social Point of View:** From social point of view, a company form of organization is considered undesirable for the following reasons:
  - The joint stock companies tend to form combinations exercising monopolistic powers against the consumers of their products and small produces in the same line;
  - A company tends to concentrate economic power in a few hands;
  - A company encourages reckless speculation in shares on stock exchange. Due to this, prices of its shares fluctuate artificially which goes against the interests of the company and discourages fresh investment in companies.
  - A company makes possible oligarchic management of its affairs. The oligarchy is harmful for the gelleral body of shareholders.

### Suitability

Despite its drawbacks, the company form of organization has become very popular, particularly for large business concerns. This is because its merits far outweigh the demerits. Many of the drawbacks of a company are mainly due to the weaknesses of the people who promote and manage companies and not because of the company system as such. The company organization has made it possible to accumulate



large amounts of capital required for large scale operations. Due to its unique characteristics, the company form of ownership is ideally suited to the following types of business:

- Heavy or basic industries like ship-building, coach-making factory, engineering firms, etc., requiring huge investment of capital.
- Large scale operations are very crucial because of economies of scale, e.g., department stores, chain stores and enterprises engaged in the construction of bridges, dams, multistoried buildings etc.
- The line of business involves great uncertainty or heavy risk, e.g., shipping and airline concerns.
- The law makes the company organization obligatory, e.g., banking business can be run only in the form of company.
- The owners of the business want to enjoy limited liability.

#### **5.2.4 Co-Operative Society**

The co-operative form of business organization developed rather late and has assumed importance gradually. As a matter of fact, it started developing to mitigate the limitations of other forms of organization and substitute the profit-motive with service-motive. Thus, it is a special form of business ownership that differs from all other forms we have discussed so far. In this type of organization, the capital is supplied by individuals who buy shares similar to those of company. Each shareholder has one vote in the management of the business, regardless of the number of shares he owns. Surplus earnings are distributed to the shareholders in the form of dividends, which are usually based on the volume of the shareholders' purchases from the co-operative in case of consumers' co-operative store, or in proportion to the goods delivered for sale to the co-operative society in case of producer's co-operative store. The primary motive behind co-operatives is to supply goods and services at a cost lower than they could be obtained from business that are operated by the owner for profit.

The International Labour Office defines a co-operative as "an association of persons, usually of limited means, who have voluntarily joined together, to achieve a common economic end through the formation of a democratically controlled business organization, making equitable contributions to the capital required and accepting a fair share of risks and benefits of the undertaking".

#### **Features of Co-operative Organization**



The features of co-operative society are as follows:

- **Voluntary Association:** A co-operative organization is a voluntary association of persons. Its voluntary character is one of the most guiding principles of co-operative organization. It implies principles of co-operative organization. It implies that every individual, irrespective of his caste, creed, religion, sex, etc. is free to become member of the co-operative and leave it any time, after giving proper notice. It also implies that none should be forced or coerced to join it.
- **Equal Voting Rights:** In co-operative form of organization, each member has equal voting right. This means that every member irrespective of his holdings of shares or status is given one vote. A rich person cannot hold control of the cooperative organization on the basis of his wealth. All members have equal voice in the management of the organization.
- **Democratic Management:** Democracy is the rule of co-operatives. In a co-operative society since each member has equal voting right, its management is essentially democratic. All the members of a society elect a body of persons to conduct and control the working of the society. The members frequently meet and give guidelines to its executive. Thus, a co-operative organization is an emblem of true democracy.
- **Service Motive:** Unlike, earlier forms of business organization, the primary objective of establishing co-operative form of organization are to render maximum service to its members. Here, the aim is not to earn profits. The co-operative societies do earn a nominal amount of profit to cover-up administrative expenses. Thus, co-operatives promote social justice.
- **Limited Return of Capital:** The capital invested in a co-operative is not given an undue preference. A limited rate of interest is allowed; because capital appreciation is not the main motto of co-operation. Under the existing law in India, a maximum of 10 per annum can be given as return on capital contribution to the co-operative. This is a first charge on surpluses of the society.
- **Separate Legal Entity:** A co-operative society must get itself registered under the Co-operative Societies Act, 1912 or under the Co-operative Societies Act of a State Government. Like a joint stock company, it is a separate legal person, it can own property, enter into contracts, sue and be sued in its own name.
- **Equitable Distribution of Surplus:** Unlike other forms, of business organization, surplus earned by a co-operative society is distributed among its members equitably on basis other than capital





contribution of the members. As per the law governing Co-operative organization, 25 per cent of its profits after meeting its trading expenses and paying a fixed rate of dividend on capital not exceeding 10 per cent is to be transferred to general reserves. In addition, a portion of the profit not exceeding 10 per cent may be utilized for the general welfare of the locality in which the co-operative society is functioning. The residual, if any, may be distributed among members on the basis to be decided by the members collectively. Normally, in case of consumers' co-operatives, this residual is distributed according to purchases made by the members from the Co-operative Society; and in case of producers co-operatives, this profit is distributed in proportion to the goods delivered to the Co-operative society for sale.

- **State Control:** The activities of the co-operative societies are subject to certain rules and regulations framed by the Government. There are many formalities which are required to be completed for getting the society registered under the Co-operative Societies Act, 1912 or the State Co-operative Societies Act of the particular State. The audited accounts and affairs of the society are inspected by the Government periodically. Besides this, a co-operative society has to submit annual reports and accounts to the Registrar of Co-operative Societies.

### Advantages of Co-operative Society

Following are the advantages of co-operative society:

- **Easy to Form:** As compared to a joint stock company, it is easy and simple to form a co-operative society. The legislative formalities required for its formation are not many. In addition to this, it is economical, as the expenses involved in its formation are comparatively less.
- **Democratic Management:** A co-operative society is managed in a true democratic way. All the members have a say in its working. They elect a managing committee on the basis of "one-man-one-vote". This committee looks after the working of the organization in the general interest of all the members. It is not controlled by vested interests only.
- **Limited Liability:** The members' liability remains limited to the extent of capital contributed by them.
- **Perpetual Succession:** Unlike sole proprietorship and partnership, it does not cease to exist on the death, lunacy, insolvency, permanent incapability etc. of its members. Like a company it has



perpetual succession; because it has separate legal entity which is not affected by the changes among its members.

- **Economic Operation:** The working in a co-operative society is quite economical. Several expenses are reduced due to elimination of the middlemen, voluntary services provided by its members, or services provided at lower salary, and also because there is no need to maintain huge stocks.
- **State Patronage:** The co-operatives have been adopted by the Government as an instrument of economic policy. Therefore, they are assisted in various ways by the Government so as to make them a success.
- **Social Benefits:** Co-operation is a philosophy and a way of life. It helps to educate members to live together. It teaches them thrift, self-help, moral values and self-government. It promotes the spirit of co-operation in place of spirit of competition. It enables them to serve others rather than exploit others. Thus, it raises the standard of living of the members and also raises moral standards of the masses.
- **Scope for Internal Financing:** Since a co-operative society has to create some compulsory reserves out of its profits, there is enough scope for ploughing back of profits in such organizations. This source of internal finance can be utilized for modernization and growth of the co-operatives.

### Disadvantages of Co-operative Society

Following are the disadvantages of co-operative society:

- **Limited Resources:** The co-operatives are not able to raise huge amounts of capital; because their membership comprises persons of limited means and is limited to local areas. The principle of one-man one-vote and limit on dividend also subdues the enthusiasm of their investing members.
- **Limited Size:** Since the principle of co-operation cannot be extended beyond a certain limit, the co-operatives are likely to fail if they choose expansion of their organization like big joint stock companies. Large-scale production or distribution is not suitable for co-operative organizations.
- **Lack of Secrecy:** A co-operative society, being separate legal entity is required to disclose fuller information to its members. Thus, secrets of the business cannot be maintained.



- **Lack of Motivation:** Since there are restrictions on the rate of dividend, the members of the managing committee do not feel motivated enough to put their best to make the organization a success.
- **Inefficient Management:** A co-operative society is managed by a managing committee which is composed of elected members who are not necessarily experts in management. Moreover, they are not in a position to attract professional managers; because they are not in a position to pay high salaries to them. Thus, the co-operatives in general, suffer from inefficient management.
- **Internal Quarrels and Rivalries:** The members of a co-operative are very enthusiastic in the beginning; but after the initial zeal is over they start showing indifference towards their organization. Often, they quarrel on petty matters. The normal working of the co-operative is affected due to factionalism among the members. This is further weakened by power politics and casteism, etc.
- **Excessive Government Interference:** The co-operatives are exposed to a considerable degree of regulation by the co-operative department. A certain degree of control is welcome; but too much of it and unwanted interference acts as a deterrent to the voluntary nature of co-operatives; it goes against the operational flexibility of the co-operatives and, thus, affects efficiency of management of the co-operatives.

### Suitability

The co-operatives are primarily suitable for small and medium size organizations and particularly for trading organizations. Since the co-operatives suffer from the limitations of limited financial resources; lack of efficient professional management, excessive Government regulation, lack of motivation, etc., they are not suitable for a large size organization. However, there are certain exceptions to this rule where the co-operatives have overcome some of their limitations mentioned above and are running their business on large-scale successfully. For instance the Kaira District Milk Producers Co-operative Union Limited, Anand, Gujarat (of Amul fame), the Indian Farmers and Fertilizers Cooperative (IFFCO), the Textile co-operatives and the consumers' co-operatives of Tamilnadu and Kerala are large-sized organizations, being run on the principle of co-operation.

### 5.3 Choice of a Suitable Form of Business Organization



After having discussed the various forms of business organization with their relative advantages and disadvantages, it would be appropriate now, to examine how a final choice is made of a suitable form of organization by the entrepreneur concerned. The choice of an appropriate form of ownership organization is an important entrepreneurial decision; because it has a bearing on income, risk and control as related to the entrepreneur. The choice of the suitable form, is never based on a single factor, it should be based on all relevant considerations concerning the business as known to the entrepreneur at the time of taking a decision.

The problem of choice of a suitable form of business organization arises at two occasions - while starting a new business and secondly, when its expansion becomes essential. It may be noted that there is no single form of business organization which may be considered the best under all the circumstances; in fact, a form of organization which is considered the best in one case, may prove to be a complete failure in another case.

At the time of launching a new business enterprise, the choice of the form of ownership is dictated by several factors as given below:

- Nature of business - Service, trade, manufacturing.
- Scale of operations - Volume of business (large, medium, small) and size of the market area (local, national, international) served.
- Degree of direct control desired by owners.
- Amount of capital required initially and for expansion.
- Degree of risk and liability and the willingness of owners to assume personal liability for debts of business.
- Division of profits among the owners.
- Length of life desired by the business.
- Relative freedom from Government regulations (flexibility of operations).
- Scope and plan of internal organization.
- Comparative tax liability.

It must be noted that these factors are interrelated and interdependent. For instance, the amount of capital required and the degree of risk involved depend upon the nature and volume of business



operations. The degree of control and the division of profits are both related to risk and liability. Therefore, an entrepreneur should not consider these factors in isolation. The interrelationship between these factors should be duly considered.

### **Choice of Form of Organization for Expanding Business**

If an entrepreneur carries out activities of his business successfully over a period of time, there is likely to be a need to expand his business so that much larger demands are easily met. Since the resources - financial and managerial - of the entrepreneur are limited, he will have to review the existing form of business organization and find out the possibility of change-over to another form to carry out the necessary expansion. Thus, while implementing the expansion programme, he has to choose between carrying on with the existing form and changing the existing form of organization. The main problems that an expanding concern will have to attend to are:

- Increased financial requirements.
- Need for internal re-organization.
- Need for specialized services.
- Increase in the risk and the personal liability of the owners.
- Retention of effective control.
- Increased tax liability.

The nature and extent of the problems mentioned above will depend upon the existing form of organization, the nature and the size of business, and the expansion programme. The various alternatives available to an entrepreneur, if he decides to change the existing form of organization, are as follows:

- A sole trader may employ a manager or change-over to a partnership.
- A partnership may have more partners or switch to a private company.
- A private company may shift to a public company.

A brief evaluation of these alternatives, on the basis of the characteristics of an ideal form of organization discussed earlier, is as follows:

### **First Alternative: Employment of Manager vs. Change-over to Partnership**



When a sole proprietor is successful in his business, it becomes essential for him to expand it to meet much larger demand. To achieve this, he needs additional capital and additional help in management. He has two alternatives. He may either employ a paid manager or may take one or more partners. The relative advantages and disadvantages of both the alternatives are examined under the following heads:

- **Re-organization:** If the sole proprietor decides to employ a manager, there will be no change in the form of existing organization. Only a 'contract of service' is to be made with the manager. On the other hand, if one or more partners are taken, there will be change in the form of organization from sole-proprietorship to partnership. This change requires entering into a partnership agreement, drafting of a partnership deed and possibly, getting the firm registered; as registration is desirable. Besides this, it is difficult to find out a partner. Thus, as compared to having one or more partners, it is easier to employ a paid manager.
- **Capital:** When a manager is employed the additional funds are to be arranged by the sole proprietor himself. There is, however, an advantage in this; the sole proprietor does not share profits with the manager and therefore, the repayment of loan is possible out of profits. In case a partner or partners are taken, additional capital will be brought in by him or them. The sole proprietor need not borrow additional funds and bear the burden of their repayment; but the partners will have to be given shares in the future profits of the firm.
- **Control:** If a manager is employed, full control of the business continues with the sole proprietor. On the other hand, if a partner is taken, control is to be shared with him unless he is a sleeping partner who contributes capital but does not participate in management. Finding such a sleeping partner, however, is difficult.
- **Management:** In case a manager is employed, the quality of management in the firm is likely to improve; because a manager possesses the necessary knowledge and skill for the purpose. However, the manager may not take full interest in the business; as there is no direct relationship between his efforts and reward; he gets fixed salary. On the other hand, if a partner with necessary managerial skills is taken, he will contribute to additional capital and will also help in successful running of the business. His interest in the business will be full; because he is going to share its profits.
- **Secrecy:** If manager is employed, the sole proprietor can keep all important business secrets to himself. In partnership, all these secrets have to be shared with partners. Therefore, in a partnership;



business secrets can be retained by the partners so long as they act in good faith and harmoniously; if they fall out, secrets may become public.

- **Business Risks:** In case a manager is employed, the sole proprietor has to bear all the business risks; He is personally responsible for repayment of loans borrowed for the business and has to suffer all the losses. In partnership, risk are shared by all the partners. They are jointly and severally liable for the acts of one another and for the entire debts of the firm.
- **Tax Advantage:** When a manager is employed, the salary payable to him is a charge against profits of the business. Moreover, interest paid by the sole trader on the loans of the business is allowed as deduction for tax purposes. If a partner is taken, share of profit payable to him is liable to tax in the hands of the firm if the firm is not registered under the Income Tax Act. Thus, in case of partnership, the tax-incidence increases.
- **Continuity:** With the employment of a manager, the form of organization does not change. Therefore, even after the appointment of the manager, the sole proprietorship remains unstable; it comes to an end with the death, insolvency or insanity of the proprietor. On the other hand, when a partner is taken, the partnership firm may be carried on by the remaining partners in case of death, insolvency or insanity of one of the partners. Moreover, because of more funds and better capacity to face risks, a partnership is in a better position to survive.
- **State Regulation:** If a manager is employed, no compliance with any regulation is required. From this point of view, a partnership is also almost at par with sole proprietorship; because state regulation in its case is minimum.

From the above it appears, that in the initial stages of expansion, employment of a manager will be better for the sole trader, provided he has managing capacity and sufficient credit standing for raising additional funds from outside, However, as the business expands further and the sole proprietor wants to diversify his business, it is advisable that he should opt for partnership. The partner(s) will not only contribute to the capital of the firm but will also be helpful in sharing the risks associated with the expanded and diversified business particularly when it is, uncertain and risky. Besides this, a partner or partners, will also contribute towards making the management of the firm effective.

### Second Alternative: Partnership vs. Private Company



As the business of the sole proprietor expands further, he is faced afresh with the alternatives of the forms of organization. He may opt for partnership, or convert his business into private company. Similarly, an expanding partnership firm is also confronted with the alternative forms of organization. The partners of such a firm may have to decide either in favor of more partners or in favor of private company. While selecting between these two alternatives, the following facts should be taken into consideration:

- **Re-organisation:** As compared to company, formation of a partnership firm is easier; because there are no legal formalities to be completed in its formation. Registration of the firm is not compulsory. On the other hand, incorporation of a company calls for the compliance of several legal formalities. Thus, on this count, the partnership enjoys a distinct advantage over a private company.
- **Capital:** For a medium-sized business, both partnership firm and private company can raise sufficient funds. However, a private company can raise more funds; because the limit on the maximum number of members is 50 as against only 20 (10 in banking business and 20 in non-banking business) in case of partnership. Nevertheless, the creditworthiness of a partnership is better because of unlimited, joint and several liability of the partners.
- **Liability:** The liability of each member of a partnership is unlimited, whereas the liability of the members of a private limited company is limited to the face value of the shares held by them. Therefore, partnership firm may be preferable for a medium-sized business with stable character. On the other hand, a private company would be a better choice for a large business of speculative nature. The limited liability is, definitely, a plus point” in favour of private company form of organization.
- **Control:** In case a partnership is formed, the original owner has to share control of the firm with other partners unless they are sleeping partners. On the other hand, in a private-company, the original owner may be able to retain effective control of the business by holding the office of the managing director of the company.
- **Management:** In a partnership, since every partner has a right to be consulted with regard to the affairs of the firm, inefficiency may creep in its management because of misunderstanding and conflict among the partners. On the other hand in case of private company, its management rests with the few elected directors who are in a position to take decisions promptly and boldly.





- **Secrecy:** Secrecy can be maintained in both the forms of organization almost equally well except that, unlike a partnership firm, a private company has to file its audited accounts with the Registrar of companies.
- **Continuity:** A partnership firm may come to an end on the death, retirement, insolvency or lunacy of a partner. On the other hand, a private company enjoys continuity and stability and is not affected by change in its members; it may last for generations.
- **State Regulation:** A partnership firm is subject to nominal Government regulation, even if it is registered. On the other hand, although a private company enjoys privileges and exemptions under the Companies Act, yet it has to comply with a large number of legal formalities which involve considerable amount of time and money. A partnership has a clear edge over a private company on this count.
- **Tax Advantage:** A partnership firm is at an advantageous position on the basis of tax liability. A partnership pays tax on its profits at progressive rates whereas a private company pays tax at a flat rate. Therefore, the tax burden is lighter in case of a partnership business than in case of a private limited company, particularly, where the scale of operations is small or medium. However, tax liability would be lower in case of a private company if the business profits are large.

Before going ahead with the re-organization of the business, the businessmen should consider all the factors mentioned above carefully. A partnership firm is as advantageous as a private company; preference for the latter may be because of the advantage of limited liability. Ultimately the decision will depend on nature and size of the business and the weight assigned to the various factors discussed above.

### **Third Alternative: Private Company vs. Public Company**

In general, for a medium-size business, both a partnership and private limited company are considered suitable. Even for a sole proprietor, whose business is expanding fast, conversion to private limited company may be advisable. He will get the benefits of limited liability and reduced tax liability; presuming his income falls in the higher income bracket. However, when a private company finds it difficult to meet the requirements of its fast growing business, it has to choose between the existing form of organization and the possibility of converting the private company into a public company. The decision will depend upon the careful consideration of the following factors:



- **Re-organization:** The formation of a private company is easier than that of a public company; because the former enjoys many privileges and exemptions. For example, a private company needs only two members for its incorporation as against a minimum of seven in a public company. A private company can commence business immediately after its incorporation whereas a public company is required to raise minimum subscription and obtain a certificate for the commencement of business. When business expands, a private company may be converted into a public company by amending the articles of association with respect to number of members, offer of shares to the public and their transferability.
- **Capital:** The amount of capital that can be raised by a private company is limited because of a limit on the number of members and restrictions on issue of prospectus to the public. The limited liability of its members puts a limit on its borrowing power. On the other hand, a public company can raise enormous amount of capital from the investors scattered throughout the country. It can also procure additional funds by issue of debentures and by borrowing from special financial institutions.
- **Control:** Since a private company is a closely controlled company, it is possible for the original entrepreneurs to retain control of the company in their hands by holding key positions on its board of directors. They can restrict the number of members of the private company to retain their control. However, in a public company, control is shared with other investors. The special financial institutions like ICICI, IFCI, IDBI, LIC, etc. which are empowered to convert their loan into equity shares may have effective check on the policy decisions of a public company. Thus, control is more personal and direct in case of a private company.
- **Management:** Both the types of company are managed by the elected Board of Directors. In case of a private company, the Board consists of the entrepreneur and his close associates, often family members. Thus, practically, there is no gap between the owners and the manager in a private company. On the other hand, in a public company, the Board consists of non-owners, also many of whom are elected because of their special managerial skills. Thus, professionalism gets boosted in company management.
- **Secrecy:** Unlike a public company, a private company is in a much better position to maintain secrecy in the conduct of its business affairs. Although it is required to file its audited annual accounts with the Registrar of Companies yet they are not open to public. On the other hand, the entire papers and documents filed with the Registrar of Companies by a public company are open to public inspection on payment of a nominal fee. Thus, a public company is not in a position to maintain secrecy of its affairs.



- **Government Regulation:** A private company, being a closely held company, is left relatively free to conduct its affairs without much Government regulation. Rather, it is granted certain privileges and exemptions. On the other hand, a public company, being widely held, involves wider public interests, and therefore, is subject to several legal formalities under various Act. The Government has been given wide powers to regulate and control the management of a public company. The regulatory provisions very often prove cumbersome and costly. Such regulations not only have adverse effect on the freedom of management but also reduce flexibility of operations.

The above analysis suggests that as far as possible an entrepreneur will try to retain his control of the organization and avoid Government control. He will, therefore, function as a private company. However, when the financial needs of business increase beyond the capacity of a private company, it needs to be converted into a public company.

## 5.4 Check Your Progress

1. Which one of the following is a feature of company?
  - (a) Transferability of shares
  - (b) Separate legal entity
  - (c) Perpetual succession
  - (d) All of the above
2. Which one is the role of entrepreneurship?
  - (a) Duties, powers and obligations of partners
  - (b) Profit sharing ratio between the partners
  - (c) Names of the partners
  - (d) All of the above
3. Minimum number of members in a public company can be.....?
  - (a) 7
  - (b) 5
  - (c) 3
  - (d) No limit



4. Which one of the followings is not a benefit of a sole proprietorship?
- (a) Easy and Simple Formation
  - (b) Direct and Exclusive Control
  - (c) Promptness in Decision-making
  - (d) Unlimited numbers of members
5. For which kind of business Co-operative society is suitable?
- (a) For small and medium size organizations
  - (b) For trading organizations.
  - (c) Both a & b
  - (d) None of the above
6. Which factor should be taken into consideration while a business decision?
- (a) Capital
  - (b) Tax incentives
  - (c) Location of business
  - (d) All of the above

## 5.5 Summary

A business organization may be owned by one person or a group of persons. Sole proprietorship is developed and owned by a single person. But other forms of organizations like partnership firm, Joint Stock Company and co-operative societies are owned and developed by group of persons. A partnership firm can be promoted with a minimum of two partners and it can have a maximum of twenty partners. A joint stock company not only helped in overcoming the limitations of sole proprietorship and partnership but also placed huge amount of capital in the hands of entrepreneur and that too with limited liability. It provided an opportunity for every person, rich or poor, to contribute to its capital. The main principle of co-operative organization is mutual help i.e. each for one and all for each. A co-operative society is a voluntary organization promoted by members of a homogeneous group of limited means on the basis of equality to serve the interests of themselves. The choice of the suitable form of business



organization is never based on a single factor, it is based on all relevant considerations concerning the business as known to the entrepreneur at the time of taking a decision.

## 5.6 Keywords

- **Entrepreneur:** Entrepreneur is an organizer who combines various factors of production to produce a socially viable product.
- **Sole Proprietorship:** The enterprise owned and controlled by one person.
- **Partnership:** It is an association of persons who have agreed to combine their financial resources and managerial abilities in running an enterprise jointly.
- **Joint Stock Company:** It is defined as a voluntary association of persons having separate legal existence, perpetual succession and common seal.
- **Co-operative Society:** It is a voluntary association of persons for mutual benefit and its objectives are accomplished through self-help and collective efforts.
- **Partnership Deed:** When the agreement of partnership is in written form, it is called Partnership Deed.
- **Innovative Entrepreneurs:** They are characterized by effective assemblage of information and the analysis of results originated from different set of combinations.
- **Economic Development:** Growth of a country in the way of GDP, per capita income etc.
- **Infrastructure:** The basic physical and organizational structures and facilities (e.g. buildings, roads, and power supplies) needed for the operation of a society or enterprise.

## 5.7 Self-Assessment Test

- What are the different ownership forms available to entrepreneurs? Discuss each form in brief.
- Explain the advantages and disadvantages of different forms of business organization.
- “None of the four forms of business ownership is best in all respects”. Discuss.
- “One man control is the best in the world if the man is big enough to control everything”. Do you agree? Give reasons.
- You plan to start a small enterprise. How would you choose the appropriate form of ownership pattern for your enterprise?



- What are the various problems likely to be faced by a firm as it expands? How can these be solved by changing the form of ownership?

### 5.8 Answers to check your progress

- 1(d), 2 (d), 3(a), 4 (d), 5(c), 6 (d)

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<b>ENVIRONMENTAL FACTORS AFFECTING SUCCESS OF A NEW BUSINESS; REASONS FOR THE FAILURE AND VISIBLE PROBLEMS FOR BUSINESS</b>	

## Structure

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- 6.1 Introduction
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  - 6.2.1 Steps to overcome problems
  - 6.2.2 Entrepreneur as Management Expert
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- 6.4 Check Your Progress
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- 6.6 Keywords
- 6.7 Self-Assessment Test
- 6.8 Answer to Check Your Progress



## 6.9 References/Suggested Readings

### 6.0 Learning Objectives

After reading this lesson, you will be able to:

- Identify the reasons for failure of new enterprise and visible problems for the business.
- Describe the suggestions to overcome the problems faced by the entrepreneurs.
- Implement the strategic management plans for business enterprise.
- Discuss the reasons of failure of business.
- Explain the skills required by an entrepreneur to run a business.

### 6.1 Introduction

Entrepreneurship will flourish only under the right atmosphere to be conducive to the social, political and economic issues. Even though the urge to excel others and to create something new is inborn and psychologically oriented in the larger analysis, this urge to excel others will fail to obtain the full freedom of expression unless the right environment is available. Thus, since entrepreneurship involves a complex of economic and social behaviour, it can only survive where conditions are ideal in terms of political, economic, social and ethical concerns, and when economic changes are free from restraints – for the benefit of all concerned. Various environmental factors influencing the success of a new business have already been discussed in lesson-2.

You had a good idea for a business. You may have just jumped into it feet first, or you may have spent months agonizing over it, planning, researching, dotting those i's and crossing those t's. Will your business survive? A lot depends on how you run your business. Every business starts out with high hopes for success, and entrepreneurs spend vast amounts of time, energy and creativity to make that success a reality. Unfortunately for most start up business, that hoped for success never materializes. About 60 per cent of all business fail within the first two years for certain industries, such as the restaurant industry, the failure rate is even higher. Although chances for business failure diminish as time passes, most businesses are never safe. Competition and changing market conditions ensure that the struggle for success never ends.





With much initiative and enthusiasms, new entrepreneurs establish business units. But many of them commit certain types of blunders, which result in total failure of the enterprise. This in fact, means wastage of the scarce resources of the nation, besides being a deterrent to new entrants.

## 6.2 Reasons for Initial Failures and Visible Problems for Business

The failure of new enterprise and visible problems for business may be traced to the following errors/oversights:

- Lack of managerial experience or poor knowledge of the particular line of production.
- Poor accounting system which results in non-availability of basic data necessary for decision-making.
- Wrong/inadequate estimate of cash requirements or faulty capital planning/budgeting.
- Lack of knowledge about tax-related matters.

A brief explanation of these factors is given below:

➤ **Lack of Managerial Experience**-The new entrepreneur should have all-round knowledge about the various aspects of management. He has to bear in mind the fact that he cannot afford to employ experts/specialists for various specialised jobs. Hence, he has to be an all-rounder in management or his job is a multifaceted one. As an all-rounder he must look after:

- What, how and when to produce;
- Marketing of the products manufactured;
- Accounting systems; and
- Finance.

The owner of a small scale industry should be well-versed in all these areas. If he fails in one of these areas, that is enough to give him heavy losses, which will result in the failure of the enterprise. A technocrat may give much emphasis on technical aspects, but ignore marketing etc. Similarly, one who is well-experienced in sales may give undue importance to marketing, but ignores technical aspects. So



what is required is a good knowledge about all the aspects of production, marketing, accounting and finance.

- **Poor Accounting System**-A good accounting system would provide information regarding costs, gross margin, break-even point etc. which are highly useful for decision-making. In the absence of proper accounting data, decision-making would be difficult and the decisions made would not give the desired effect.
- **Inadequate Estimate of Cash Requirements**-A proper estimate of cash requirements will help the proper functioning of the enterprise. A new enterprise feels cash crunch when – (a) production does not reach optimum level, (b) production is below the break-even point, (c) it fails to create and increase the demand for the product/services. All these factors result in the depletion of cash very easily. This is because the time required for these has been calculated wrongly. Delay in any one of these activities means more cash requirements. Hence the entrepreneur has to estimate the time and also how a month-by-month delay in starting the project would proportionately increase the capital requirements. Costs escalate with the passage of time; therefore calculations have to be made in advance taking into account the capital requirements by taking the time factor.
- **Lack of Knowledge about Tax Related Matters**-The entrepreneur must make himself aware of the provisions relating to income-tax and sales tax. He must pay special attention to sales-tax laws and regulations – especially obtaining sales-tax registration at the appropriate time, filing tax returns regularly etc.

### 6.2.1 Steps to Overcome Problems

Many studies have been conducted to identify the problems faced by the new enterprise. These studies have mainly pinpointed the above problems and the following suggestions have been made to overcome these problems:

- Make an intensive study of the proposed project/product/service. Spend a lot of time in preparing budgets, cost estimates, collecting market information etc. These are required to make the proposed venture as realistic as possible. Once the project has been started it may not be possible to consider or make changes.



- Financial prudence requires that one has to adopt a conservative attitude towards estimating income and liberal in expenses, at the same time there should be wide margin of safety.
- It is advisable to make use of the services of bankers, management and tax consultants, suppliers, etc. to examine the proposed project and elicit their suggestions.
- Accurate accounting information is vital for the running of the enterprise. Hence, the services of a professional accountant should be made use of in devising an appropriate accounting system.
- Professional investors always look for lucrative ventures. If professional investors are associated with the venture, they will scrutinize it from different angles before making any investment. This will help the entrepreneur in determining whether the project is feasible or not and give good returns.
- Complying with taxation formalities and paying taxes have become a regular headache for many entrepreneurs. The entrepreneurs should collect all information regarding various types of taxes such as income-tax, sales-tax, excise duties etc. even before the unit is started. They must familiarize with changes taking place in taxation laws and see the unit gets the benefits or advantages of certain taxes. Income-tax, and excise duties come under central laws whereas sales-tax some under state laws.

### **6.2.2 Entrepreneur as Management Expert**

A new entrepreneur sometimes faces hostile business environment reflected through intense competition, imitation of products, duplication of services and the presence of dishonest persons bent upon cheating and committing frauds. It is not necessary for everyone to presume the presence of these odds in market place but one must be ready to face the situation as it emerges at any moment.

To face such odds, one must follow modern management tools. In the present context it is the strategic management which requires preparing a game plan to guide the entrepreneur or firm in achieving basic objectives of the business. The plan must discuss strength and weakness (S or W), opportunities and threats while facing the environment. A few experts even suggest that this game plan should be a strategic plan that gives a competitor's edge to the enterprise to solve basic urgent questions faced on startup. Otherwise also, the small business in itself is a strategic plan as small firms always have



advantages over their larger competitors. This is so because small business has narrower product line and a better defined customer base. Small firms fathom specific geographic market area and consequently the natural advantages in strategic management. It is well known that the techniques of big flexible managerial style, informal organisational structure with adaptability of change enjoyed by the SSI units and they need different approach to strategic management.

- **Ingredients of Strategic Management for Business Enterprises**-Strategic management for business enterprises should include the following, i.e. (i) Short term plan for less than 2 years; (ii) informal structure; (iii) greater employees participation and outside parties to improve reliability of plan; and (iv) focus on thinking than on planning or setting objectives; and (v) be flexible to adjust the realities of daily routine. For strategic management, strategic planning is done which should be based on entrepreneur's own idea for product or service that is valuable to the society and has potential to produce profits.

### 6.2.3 Strategic Management for Business Enterprises

For any entrepreneur, strategic management is state of preparedness to meet challenges emerging from unforeseen circumstances of the business. Therefore, the business plan which an entrepreneur prepares should be of short duration that is of less than two years so as to accommodate changes in near future and to avoid risk of uncertainties of distant future. Employees' participation should be encouraged in management so that the ground realities daily emerging could be well understood and activities are planned and adjusted accordingly.

Strategic management is based on strategic planning as already described above. But such strategic planning should be based on considerations such as clear vision and a meaningful mission of the management; entrepreneur's own driving force and position of the enterprise in the market; assessment of the firm's strength and weaknesses; scanning business environment and available opportunities; strategic options and selection of appropriate strategy; and using accurate control measures for assessing the results.

For an entrepreneur it is not difficult to follow the above game plan strictly. Each of the above steps is briefly narrated below:



- **Clear vision and meaningful mission** -One must know the purpose of the business. To achieve this purpose one must have clear path to reach to it. This requires defining the jobs and designing the operational structure to set the work in preferred coordinating spirit and manner.
- **Driving force and market position**-Unless market position is clearly assessed and defined, no driving force will work. One must identify, within the market area, the customers aimed at to be served.
- **Strength and weakness**-One must study the positive as well as negative internal factors and make sincere attempt to overcome negative factors by building strong positive factors. For example lack of skill be overcome by building specific skills; lack of know-how in any specified area be suppressed by accurate and requisite knowledge in that area and likewise.
- **Scanning Business Environment**-Business environment play significant role for the success of the enterprise. Here, entrepreneur must scan environment viz. Macro-environment covering economic, social, political, technological conditions prevailing in the country and changes taking place to judge their individual and combined impact on the business activity of the entrepreneur; Micro environment to know placement of the product in the specific industry classification. Industry environment will reveal the strength of the competitors in the industry. The future prospects of the product, its substitutes and market share the industry commands, customers' behaviour or competitors strategies both could be known through such analysis. This enables entrepreneur to balance his own strength and weakness against the opportunities and threats these market forces present. Sources of information for the study of business environment are plenty viz.
  - Publications of industry or trade associations;
  - local newspapers;
  - competitors press releases, literature, advertisement, brochure, etc.;
  - attend sales manager's periodical meeting to get feedback of competition;
  - Purchase competitors products and analyse it for useful publicity information;
  - customers' grievances, opinions and suggestions;



- Government reports, publications, policy statements, etc.
  - Attend industry and trade fairs etc.
- **Strategic options and strategies**-In the light of the above findings, entrepreneur should redefine its goals, revise its strategies, modify action plans and redraft approaches. In other words, to achieve objectives, adopt competitive strategy. For example, to attain price leadership the firm must produce low cost products than competitors. For that purpose, reduce manufacturing cost by changing process or inputs without compromising with quality or different products but win over the customers loyalty to the brand and likewise steps could be taken.
- **Accurate Control Measures**-For success in any field, one must know the gaps between planned objectives and the achievements and the reasons for such a gap to remedy the loopholes. Such control measures should cover different areas in the work floor i.e. production department performance through employee performance; sales department performance through turnover and revenue realization and product's performance through customer's satisfaction and demand analysis, etc.

The task of strategic management is rendered easier if the entrepreneur prepares a file each of the above areas and keeps on filing the collected information in each separate file and periodically analyse the information collected therein. By doing so, the entrepreneur will be nearer to the goal of strategic planning. These efforts will fetch success to the business enterprises, if their entrepreneur is properly trained and his skills toned up.

### 6.3 Why Does Business Fail?

The U.S. Small Business Administration conducted a study that looked at the reasons for small business failure. Here are the major reasons ranked according to frequency:

- Inadequate front-end planning: No business plan prepared; no feasibility study done and no cash flow projections done.
- Insufficient Capital for Startup and Back-up: Even most dedicated works cannot overcome ongoing capital deficiencies due to startup losses.



- Inexperienced Management: Insufficient experience in the management and the day-to-day operations of the business or of any business.
- The Wrong Location: Low traffic, no expansion area, changing characteristics of the neighborhood. The customers are out there, but the business is not convenient because of driving and parking distance, transportation costs, and employee unwillingness to live in the community.
- Inventory Mismanagement: Too much of the wrong inventory.
- Too much Capital in Fixed Assets: The failure to properly anticipate the cost of equipment and real estate needed to start and expand.
- Poor credit practices: Failure to properly extend and control credit policy and practices.
- Unplanned expansion: If one location is doing well, a second doesn't mean the business will do twice as well unless management is available.
- Having the wrong attitude: Not ready to work longer and harder than ever before; too much money in trappings and appearance.
- Inadequate Records and Financial Knowledge: Unwillingness to employ and work with a banker, accountant, and a lawyer.
- Lack of Managerial Foresight: Failing to build staff to compensate for the weaknesses of the founder or owner; failing to adequately compensate second-line management.

Michael Gerber, founder and CEO of Gerber Business Development Corporation, author of *The E-Myth: "Why Most Small Business Don't Work and What To Do About It"* (Harper Business), has compiled, based on his 17 years of small business research, his own list of reasons why small business fail. Among the reasons he cites:

- **Lack of Management Systems**-Most entrepreneurs has no systematic way of generating information or determining what is and is not working. Also, there is little or no effort to covert data into usable information.



- **Lack of Vision and Purpose by the Principles-**Entrepreneurs need to view their business as a means to an end. Bill Gates, for example, has become successful because his purpose was to put a computer in every home and his business was a way to achieve that goal – not vice versa.
- **Lack of financial planning and review-**Most self-employed people concentrate primarily on generating income when they should be most concerned with building equity.
- **Poor Market Segmentation or Strategy-**Most entrepreneurs don't know who their customers are. Factors such as customer age, geographic locations, and family size can have an impact on what and how they buy.
- **Competition or lack of market knowledge-**The self-employed are often so engrossed in the daily task of running a business that the last thing they think about is what their competition is doing and how they can do it better.
- **Inadequate capitalization/under-funded-**Although this factor commonly rates as the primary reason for business failure, it is actually a symptom of underling problems.

### 6.3.1 On the Upside

It's true, there are a lot of reasons not to start your own business. But for the right persons, the advantages of business ownership far outweigh the risks.

You get to be your own boss.

Hard work and long hours directly benefit you rather than increasing profit for someone else.

Earning and growth potential are far less limited.

A new venture is exciting. Running a business will provide endless variety, challenge and opportunities to learn.

### 6.3.2 Getting Started

Starting and managing a business takes motivation, desire and talent. It also takes research and planning. Like a chess game, success in small business starts with decisive and correct opening moves. And although initial mistakes are not fatal, it takes skill, discipline and hard work to regain the advantage.





To increase your chance for success, take the time up-front to explore and evaluate your business and personal goals. Then use this information to build a comprehensive and well-thought-out business plan that will help you reach these goals.

The process of developing a business plan will help you think through some important issues that you may not have considered yet. Your plan will become a valuable tool as you set out to raise money for your business. It should also provide milestones to gauge your success. Before starting out, list your reasons for wanting to go into business. Some of the most common reasons for starting a business are

You want to be your own boss.

You want financial independence.

You want creative freedom.

You want to fully use your skills and knowledge.

Next you need to determine what business is "right for you". **Ask yourself these questions**

What do I like to do with my time?

What technical skills have I learned or developed?

What do others say I am good at?

Will I have the support of my family?

How much time do I have to run a successful business?

Do I have any hobbies or interests that are marketable?

Then you should identify the niche your business will fill. Conduct the necessary research to answer these questions:

What business is I interested in starting?

What services or products will I sell?

Is my idea practical, and will it fill a need?

What is my competition?



What advantage does my business have over existing firms?

Can I deliver a better-quality service?

Can I create a demand for my business?

The final step before developing your plan is the pre-business checklist. You should answer these questions:

What skills and experience do I bring to the business?

What will be my legal structure?

How will my company's business records be maintained?

What insurance coverage will be needed?

What equipment or supplies will I need?

How will I compensate myself?

Where will my business be located?

What will I name my business?

Your answers will help you create a focused, well researched business plan that should serve as a blueprint. It should detail how the business will be operated, managed and capitalized.

### 6.3.3 Entrepreneurial Skills

Similar to the game of chess, success in business starts with decisive and correct opening moves. And although initial mistakes are survivable, it usually requires skill, discipline and hard work to regain the advantage.

There are five basic skills anyone must have to run any kind of business:

- **Basic money-management skills**-While you don't need to have a lot of money to start a business successfully, you do need the ability to make the most of the money that you have. Being able to focus on the bottom line and pay attention to the numbers is as essential as the ability to price your products and services, manage your cash flow, and make sure you collect payment for the work you do. If you are lacking in these skills, you can get training in business.



- **A Marketing Mindset**-You aren't truly in business until you have business. No matter how much your product or service is in demand or how great a job you do, if people don't know about you, you won't have much business. You must be able to make your business visible the people who need it, and this means understanding marketing.
- **Self-management skills**-To make it on your own, you must become a goal-directed and self-motivated individual. You must be able to get yourself started every day, stick to business, and close the door on work at the day's end.
- **Time-management skills**-In your business, you will need to wear many hats, from chief executive officer to janitor. You'll have to do the business, get the business, and run the business. This means you'll need to manage your time effectively to make sure the most important and urgent things get done in a timely fashion.
- **Basic Office Organization**-Since one of the roles you'll probably play is that at your own office administrator, you will need to be able to organize, equip and manage your office space so that you can work effectively in it, having a place for everything and keeping everything in its place so that you can find it easily when you need it.

## 6.4 Check Your Progress

1. Which one of the following is the reason of failure of new enterprise?
  - (a) Lack of managerial experience
  - (b) Poor accounting system
  - (c) Lack of knowledge about tax-related matters
  - (d) All of the above
2. Which steps can be taken to overcome problems?
  - (a) Make an intensive study of the proposed project
  - (b) Accurate accounting information system
  - (c) Use of the services of bankers, management and tax consultants
  - (d) All of the above



3. Which one not included in ingredients of strategic management for business enterprises?

- (a) Short term plan for less than 2 years
- (b) Informal structure
- (c) None of the above
- (d) Greater employees participation and outside parties

4. Strategic planning should be based on considerations like.....?

- (a) Clear vision and a meaningful mission
- (b) Entrepreneur's own driving force
- (c) Position of the enterprise in the market
- (d) All of the above

5. Which one of the following is entrepreneurial skill?

- (a) Basic money-management skills
- (b) A Marketing Mindset
- (c) Both a & b
- (d) None of the above

6. Is environmental scanning must for businessmen before starting a new business?

- (a) Yes
- (b) No
- (c) Cannot say
- (d) None of the above

## **6.5 Summary**

With mush initiative and enthusiasm, entrepreneurs start their venture. But many of them commit certain types of blunders, which result in total failure of the enterprise. This in effect means wastage of the scare resources of the nation, besides being a deterrent to new entrants. Many studies have been conducted to identify the problems faced by the entrepreneurs. These studies have mainly pinpointed



the problems and made certain suggestions to overcome these problems. For any entrepreneur, strategic management is state of preparedness to meet challenges emerging from unforeseen circumstances of the business.

The failure of new enterprise and visible problems for business may be due to lack of managerial experience or poor knowledge of the particular line of production; poor accounting system which results in non-availability of basic data necessary for decision-making; wrong/inadequate estimate of cash requirements or faulty capital planning/budgeting and lack of knowledge about tax-related matters.

These problems can be overcome by making an intensive study of the proposed project/product/service; financial prudence requires that one has to adopt a conservative attitude towards estimating income and liberal in expenses, at the same time there should be wide margin of safety; use of the services of bankers, management and tax consultants, suppliers, etc. to examine the proposed project and elicit their suggestions; accurate accounting information system; make it lucrative venture; Complying with taxation formalities.

Strategic management is based on strategic planning. But such strategic planning should be based on certain considerations such as clear vision and a meaningful mission of the management; entrepreneur's own driving force and position of the enterprise in the market; assessment of the firm's strength and weaknesses; scanning business environment and available opportunities; strategic options and selection of appropriate strategy; and using accurate control measures for assessing the results. Further, for an entrepreneur it is not difficult to follow the above game plan strictly. Five basic skills are required by everyone to run any kind of business.

## 6.6 Keywords

- **Break-even Point:** It is that point where there is no profit no loss.
- **Creativity:** It is a purposeful, organized, risk taking change introduced for the purpose of maximizing economic development.
- **Business Plan:** A comprehensive set of guidelines for a new venture.
- **Environmental Scanning:** Study and analysis of the micro and macro environmental factors to know the possible effects on the business.



- **Entrepreneurial skills:** These are the qualities of an entrepreneur for the proper management of their business like a marketing mind, knowledge of market and competition etc.
- **Strategic management:** It is the ongoing planning, monitoring, analysis and assessment of all necessities an organization needs to meet its goals and objectives.
- **Accounting Information System:** It is a system of collecting, storing and processing financial and accounting data that are used by the decision makers.
- **Strength and weakness-**The positive and the negative features of a company. One must study the positive as well as negative internal factors and make sincere attempt to overcome negative factors by building strong positive factors.
- **Employees participation:** Involvement of employees in the decision making process of the organization.
- **Vision and Mission:** The future position of the company is described in the vision statement. The mission statement describes the objectives of the company.

## 6.7 Self-Assessment Test

- Discuss the various environmental factors affecting the success of a new business.
- State the reasons for failure of business and how these problems can be overcome.
- Write a short note on the followings:
  - (i) Strategic Management for Business Enterprises
  - (ii) Entrepreneurial Skills
  - (iii) Entrepreneur as Management Expert

## 6.8 Answers to check your progress

- 1(d), 2 (d), 3(c), 4 (d), 5(c), 6 (a)

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<b>PROJECT FORMULATION</b>	

## Structure

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## 7.0 Learning Objectives

After reading this lesson, you will be able to:

- Define a project and explain the different stages of project life cycle.
- Make a classification of the project
- Discuss the areas from where project ideas may emerge.
- Describe a Project Report and explain its contents.
- Discuss how to prepare a project report.
- Explain the factors to be considered while making a project appraisal.
- Enlist the common errors made by entrepreneurs while formulating a project.

### 7.1 Introduction

The very foundation of an enterprise is the project. The success or failure of an enterprise depends on the project. Hence, the project is of crucial importance to the entrepreneur. The dictionary meaning of project is an idea or plan that is intended to be carried out in the future or that is being carried at present. A project is a cluster of activities that is relatively separate and clear-cut, e.g., building a factory, hospital etc. A project typically has a distinct mission that is designed to achieve and clear termination point, the achievement of the mission. In common parlance, the term project is used to refer to projects such as industrial projects, agricultural projects, illiteracy eradication project etc. An entrepreneur has to implement an idea or plan and see that he achieves it – that is, he completes the project successfully.

### 7.2 Meaning of Project

Gittinger defines project “as the whole complex of activities involved in using resources to gain benefits”. An entrepreneur implements a project overcoming various hurdles, with a view to get some benefits - mainly monetary rewards. The entrepreneur originates the idea, makes a detailed study of the various aspects of the project to be implemented, estimates the profit that would accrue from the project, and finally implements it.

#### 7.2.1 Project Life Cycle

A project has to pass through three distinct stages:



- **The Pre-investment Stage**-It covers setting of aims and objectives, forecasting of demand, selection of best means or strategies to achieve objectives, evaluation of characteristics of resources or inputs required projection of financial plan, cost-benefit analysis and ultimately, the pre-investment appraisal. The project idea is converted into a concrete investment proposal or scheme on which promoters and financiers can base their investment decision.
- **The Construction Stage**-It starts after the investment decision is taken. Resources in the form of land and buildings, plant and machinery, transport, communication and other services, control systems, sales, and marketing organization, managerial personnel, acquisition of materials and supplies, etc., are assembled and all these resources are allocated to develop or create a tangible project which is ready to achieve the set objectives.
- **The Normalization Stage**-The allocated resources of assets (created during the second stage) are utilized or employed to produce the end results, i.e., output of goods or services which are required to fulfill the project objectives. The project starts operating, i.e., processing inputs and generating outputs.

### 7.2.2 Project Classification

Projects have been classified in various ways by different authorities. Little and Mirreless divide the projects into two broad categories, viz., quantifiable projects and non-quantifiable projects. The planning commission has accepted the sectoral criteria for classification of projects. Projects can also be classified on the basis of techno-economic characteristics. All India financial institutions classify the projects on the basis of the nature of the projects and its life cycle. The project classification is explained below:

- **Quantifiable and non-quantifiable projects:** Quantifiable projects are those in which a plausible quantitative assessment of benefits can be made. Non-quantifiable projects are those where such an assessment is not possible. Projects concerned with industrial development, power generation, and mineral development are forming part of quantifiable projects. The non-quantifiable projects category comprises health, education and defense.
- **Sectoral Projects:** According to the Indian Planning Commission, a project may fall in the following sector:



- Agriculture and Allied Sector
- Irrigation and Power Sector
- Industry and Mining Sector
- Transport and Communication Sector
- Social Services Sector
- Miscellaneous Sector

The sector classification of projects is quite useful for resource allocation at macro levels.

➤ **Techno-Economic Projects:** Techno-economic projects classification includes factors intensity-oriented classification, causation-oriented classification and magnitude-oriented classification. These three grouping are narrated as under:

- **Factor intensity oriented classification:** The factor intensity is used as base for classification of projects such as capital-intensive or labour-intensive which depends upon the large scale investments in plant and machinery or human resources.
- **Causation oriented classification:** The causation-oriented projects are determined based on its causes namely demand based or raw material-based projects. The non-availability of certain good or services and consequent demand for such goods or services or the availability of certain raw materials, skills or other inputs is the dominant reason for starting the project.
- **Magnitude oriented classification:** The size of investments forms the basis for magnitude-oriented projects. Projects may thus be classified based on its investment such as large-scale, medium-scale projects.

Techno-economic characteristics based classification is useful in facilitating the process of feasibility appraisal. United Nations and its specialized agencies use the International Standard Industrial Classification of all economic activities (ISICO) in collection and compilation of economic data. Since this classification covers the entire field of human economic endeavor, it forms a useful basis for classification of projects. Economic activities under this classification are grouped into ten divisions, which are subdivided into ninety sub-divisions. The divisions are:



Division	Economic activities
Division 0	Agriculture; Forestry, Hunting and Fishing
Division 1	Mining and Quarrying
Division 2&3	Manufacturing
Division 4	Construction
Division 5	Electricity, Gas, Water and Sanitary Services,
Division 6	Commerce
Division 7	Transport, Storage and Communications
Division 8	Services
Division 9	Activities not adequately described

➤ **Financial Institutions Classification:** All India and State Financial Institutions classify the projects according to their age and experience and the purpose for which the project is being taken up. They are as follows:

- New projects
- Expansion projects
- Modernization projects
- Diversification projects

The projects listed above are generally profit - oriented and the services oriented projects are classified as under

- Welfare Projects
- Service Projects
- Research and Development Projects
- Educational Projects

### 7.2.3 Project Identification



Project identification is a difficult task faced by an entrepreneur. He comes across several investment opportunities. In the first instance, he has to select a few projects which have been subjected to preliminary evaluation. Project identification is concerned with the collection, compilation and analysis of economic data for the eventual purpose of locating possible opportunities for investment and with the development of the characteristics of such opportunities.

According to **Peter F. Drucker**, opportunities are of three kinds: additive, complementary and breakthrough. *Additive opportunity* is concerned with utilizing the existing resources without making any change. *Complementary opportunity* results in introduction of new ideas and involves change. *Breakthrough* involves drastic and fundamental changes in the existing business. Risk is least in additive opportunities, greater in complementary and greatest in breakthrough opportunities. Bearing in mind these factors and expecting a fair return on investments, the entrepreneur has to choose a project. A few guidelines which help him choose the right line of project are given below.

### Choosing the Right Line of Activity

The primary decision to be made by a prospective entrepreneur is choosing the right line of activity. The very success of his venture will depend on the rationality of his decision in the regard.

A business opportunity is born as an impulse during the course of interaction of the entrepreneur with the environment. He proceeds if a competitive advantage is sensed in the following three areas:

- Procurement of scarce resources.
- Access to technical know-how.
- Market.

Now-a-days more importance should be given to the third factor, i.e., market.

Then a business potential examination involving a cursory examination of the market, production and financial parameters is done through further reading/discussions to see whether the competitive advantage sensed earlier could be exploited to set-up an industry of the magnitude envisaged.

A satisfactory response invokes further probing in the form of market survey, feasibility study, etc. If the scheme looks attractive and the degree of calculated risk provides the entrepreneur with an adequate



level of confidence, he embarks on further development like a detailed project report, raising funds, obtaining detailed know how, etc.

Primarily the choice of a product is the identification of a market niche and comprises an analysis all analysis based on answers to questions such as:

- Is there an unfulfilled need for this product?
- What are the unique features that distinguish this product or service from those offered by other firms?
- Who is the potential customer?
- How and at what cost is the customer to be informed of the product or service? What is the estimated size of the market?
- How should product or service be distributed?
- What prices can be charged which will be competitive yet yield a reasonable profit?
- What are the personal strengths and weaknesses which meet/detract from meeting the above identified-needs of the market?

Before taking a decision on the line of activity it is imperative for the promoter to have an interaction with the environment over as wide an areas as possible, so that the ambit, within which he makes the decision, is large enough to enclose most of the opportunities around.

Some important areas from which product ideas may emerge are the following:

- Survey of raw materials - agricultural, minerals, forest, animal husbandry, etc.
- Survey of local skills based on which suitable industries can be identified.
- Study of import statistics may reveal some commodities which can be indigenously manufactured.
- Study of export statistics will indicate trends in exports and the possibility of increasing exports for certain products. It may indicate certain products which can be further processed in the country.
- Study of world trade may indicate certain goods in which the country enjoys price advantage and can be manufactured for exporting.
- Study of the stores requirement for major industries and organizations will reveal the requirement of various items.



- Study of development plans will reveal future requirement for certain products or services.
- Study of Government policies regarding industrialization, exports, imports, development of backward areas, etc.
- Study of new process/products developed by organizations like National Research Development Corporation, Directorate General of Technology Development, Council of Scientific and Industrial Research, Indian Space Research Organization, Bhabha Atomic Research Centre, etc.
- Study of prospects for ancillarisation.
- Study of potential for tourism – hotels, motels, house boats, etc.
- Project ideas also develop while seeking solutions to our day-to-day problems.

But in reality, the case is quite different. A major constraint faced especially in developing countries is the resources constraint. Hence it becomes imperative that certain project ideas are only taken up or pursued in preference to others. How to make this decision or choose only a few projects for implementation? Project formulation techniques help us in making a choice. When we say project formulation, we mean that a project idea is presented in such a form that it can be subjected to comparative appraisal. This process will aid in definitely determining the priority of projects from the point of view of resource allocation. The project ideas can be analyzed from the point of view of inputs as well as outputs. Such an analysis when presented to decision maker or to consulting agencies will help them in decision-making. This strategy analyses project ideas not only from the view point of technical feasibility and financial viability but also evaluates the sum total effect which the project will have on the society and the immediate environment.

#### **7.2.4 Project Formulation**

Project formulation is defined as taking a first look carefully and critically at a project idea by an entrepreneur to build up an all-round beneficial to project after carefully weighing its various components. It is formulated by the entrepreneur with the assistance of specialists or consultants. Project formulation is, therefore, a process whereby the entrepreneur makes an objective and independent assessment of the various aspects of an investment proposition of a project idea for determining its total impact and also its liability. By all means, this strategy forms an important stage in the pre-investment phase – that is the period from the conception of an idea until the final analysis to



decide about the future of a project idea. This makes it an analytical management aid. The aim of project formulation is to achieve the project objectives with the minimum expenditure and adequate resources. In other words, it is to derive maximum benefits from minimum expenses in a short span of time.

Formulation of project report business plan is one of the corner stones to be laid down in setting up an enterprise. This section is devoted to make you understand what is and how to make a right project report.

### **7.2.5 Project Report**

After having selected the project/product or the service to be rendered, the entrepreneur has to prepare a project report. A project report is a report which provides all the necessary information of the unit proposed to be set-up for the manufacture of a product or rendering a service. Financial institutions and banks require project report for providing financial assistance. Various developmental agencies which help set-up the project also require project report. A well-prepared project report will help the bankers in appraising the project report and offer financial assistance. A project report enables the entrepreneur to know how much money, man-power and material would be required to set-up the project, type of machine and technology required and the economic gains from the project. Information regarding economic, technical, financial, managerial and production aspects of the project/service are covered by the project report.

There are chartered accountants, technical consultants, and management consultants etc., who prepare a project report on behalf of the entrepreneur. Many time an entrepreneur feels that he would relieve himself of the tension to prepare a project report by engaging a consultant. Experience in developing entrepreneurs has shown that a well perceived, well-made project report by the entrepreneur himself is helpful to him while running the industry. This is so because, the process of preparing the project report enables him to interact with realities and makes him aware of what to expect in the future when he actually implements the project. It's a "drill", a good training prior to jumping into a venture. Therefore, even when he chooses to take the help of a consultant, he must involve himself in the preparation of the project report.

### **Significance of Project Report**





An objective without a plan is a dream. The preparation of a project report is of great significance for an entrepreneur. The important uses of project report are:

- It helps in approaching District Industries Centre for obtaining provisional/permanent registration.
- It helps in procuring developed land or shed from Directorate of Industries or from the Development Corporation meant for providing developed land/sheds' to entrepreneurs.
- It helps in securing supply of scarce raw materials.
- It helps in approaching bank for getting working capital loan.
- It helps in obtaining term loan from State Financial Corporation/Bank.
- It helps the entrepreneur in establishing techno-economic viability of the project.

### Contents of a Project Report

Having gone through the significance of project report, it is now clear that there is no substitute for a well-prepared business plan or project report and also there are no short-cuts to preparing it. The more concrete and complete the business plan, the more likely it is to earn the respect of outsiders and their support in making and running an enterprise. Therefore, the project report needs to be prepared with great care and consideration. A good project report should contain the following contents:

- **General Information:** Information on product profile and product details.
- **Promoter:** His/her educational qualification, work experience, project related experience.
- **Location:** Exact location of the project, lease or freehold, vocational advantages.
- **Land and Building:** Land area, construction area, type of construction, cost of construction, detailed plan and estimate along with plant layout.
- **Plant and Machinery:** Details of machine required, capacity, suppliers, cost, various alternatives available, cost of miscellaneous assets.
- **Production Process:** Description of production process, process chart, technical knowhow, technology alternatives available, production programme.
- **Utilities:** Water, power, steam, compressed air requirements, cost estimates, sources of utilities.
- **Transport and Communication:** Mode, possibility of getting, costs.



- **Raw Material:** List of raw material required by quality and quantity, sources of procurement, cost of raw material, tie-up arrangements, if any, for procurement of raw material, alternative raw material, if any.
- **Manpower:** Manpower requirement by skilled and semi-skilled sources of manpower supply cost of procurement, requirement for training and its cost.
- **Products:** Product mix, estimated sales distribution channels, competitors and their capacities, product standard, input-output ratio, product substitute.
- **Market:** End-users of product, distribution of market as local, national, international, trade practices, sales promotion devices, and proposed market research.
- **Requirement of Working Capital:** Estimation of working capital required, sources of working capital, need for collateral security, nature and extent of credit facilities offered and available.
- **Requirement of Funds:** Break-up of project cost in terms of costs of land, building, machinery, miscellaneous assets, preliminary expenses, contingencies and margin money for working capital, arrangements for meeting the cost of setting up of the project.
- Cost of Production and Profitability of first ten years.
- Break-Even Analysis.
- Schedule of Implementation.

### Formulation of a Project Report

A project is a report which provides all the necessary information of the unit proposed to be set-up. It is required by various developmental agencies that help, setting-up of the unit and particularly by financial institutions and banks to provide financial assistance. The report should be prepared in such a way that it is able to provide complete information that may be required by financial institutions for appraising the project. A well prepared project report will not only save the time energy of the banker but also help the entrepreneur, who will not face many objection and queries from the banker.

A general set of information given in any project report is listed by Vinod Gupta in his study on “Formulation of a Project Report”, which is reproduced, below, the following are broad heads under which complete information on relevant aspects should be included in the project report:

- General Information.



- Project Description.
- Market Potential.
- Capital Costs and Sources of Finance.
- Assessment of Working Capital Requirements.
- Other Financial Aspects.
- Economic and Social Variables.

**General Information:** To begin with, some information of general nature should be provided. The following are some such aspects:

### **Bio-Data of Promoters**

- Name and address of the entrepreneur.
- The qualifications, experience and other capabilities of the entrepreneur. If there are partners, state the characteristics of all the partners individually.

### **Industry Profile**

- A little reference of analysis of industry to, which the project belongs, e.g., past performance, present status, the way it is organized, the problems it faces, etc.

### **Constitution and Organization**

- The constitution and the organizational structure of the enterprise. In case of a partnership firm, whether it is registered with the Registrar of Firms.
- Whether a Registration Certificate from the Directorate of Industries/District Industries Centre has been obtained or will be applied later on.

### **Product Details**

- The utility of the product and the range of products is to be manufactured. One could even provide the product designs/drawings along with and made a mention of the advantages the proposed product offers over its substitutes.

**Project Description:** A brief description of the project covering the following aspects should be given in the project report.



- **Site:** Location (town, street, number etc.) whether owned or leasehold land; whether the site is in approved industrial area? Is it suitable to the type of enterprise being planned? The open/covered area availability needed should be mentioned. If the location is in a residential area then the copy of No Objection Certificate from the Municipal authorities should be attached.
- **Physical Infrastructure:** Availability of physical infrastructure consisting of the following items:
- **Raw Material:** Whether imported raw material is also required? If so, whether the license has been obtained or not? What are the sources of raw material and what is the probability of getting it on a continuous basis at fair prices?
- **Skilled Labour:** Whether skilled labour is available in that area? If not, what arrangements have been made to train the labour in various skills?
- **Utilities**
  - **Power:** Inadequate supply of electricity or its high unit cost in an area may become a major constraint in running a project. The project report should contain the information regarding the power requirements, the load sanctioned, stability of supply of power and the price at different consumption levels.
  - **Fuel:** Whether other fuel items like coal, coke, oil or gas, are required and if yes, then state their availability position.
  - **Water:** Water is an important factor for projects like brewery, tannery, ice plant, soft drinks and chemicals. The source and the quality of water in such cases should be clearly stated.
- **Pollution Control:** Most industrial plants produce waste material or emissions that may create significant problems. The emission may be of various types like (i) gaseous (smoke, fumes, etc.) (ii) Physical (noise, heat, vibration, etc.) or (iii) liquid or solid discharge through pumps and sewers. State clearly the aspects like scope of dumps, sewage system and sewage treatment plant.
- **Communication System:** Availability of communication facilities, e.g., telephone, telex etc. should be stated in the report.
- **Transport Facilities:** The distances over which the basic material inputs will have to be transported and the available as well as potential means of transportation should be stated together with expected bottlenecks, if any.



- **Other Common Facilities:** Availability of facilities like machine shops, welding shops and electrical repair shops, etc.
- **Manufacturing Process:** The details of production and the process involved should be clearly stated. Also state the period of conversion from raw material into finished goods. A process flow chart should be presented.
- **List of machinery and Equipment:** A complete list of items of machinery and other equipment indicating their type, size and cost should be furnished. Sources of supply of capital equipment and the construction services should also be given. Check machinery/equipment for each of the above stated processes is ensured. If not, explain how such processes will be get done.
- **Capacity of the Plant:** The installed licensed capacity should be stated. Also state whether the unit will run on single, double or triple shift basis.
- **Technology Selected:** Is it up-to-date and appropriate? Which other units are using the same technology and with what results? How is required know how proposed to be arranged?
- **Balancing of Plant:** While stating the stages of production, also state whether the capacity of various plants at different stages of production is sufficient. Balancing equipment required at a later stage and the consequent increase in capacity should be assessed.
- **Quality Control/Testing and Inspection:** Whether some system has been designed to check the quality of products on a continuous basis? Obtaining quality marks like ISI, Agmark help in creating confidence among consumers if there is a probability of getting them for the products, the fact should be included in the project report.
- **Research and Development:** Besides the quality control, whether any cell to study improvement of quality is proposed to be formed in the enterprise?

**Market Potential:** The following aspects relating to market potential should normally be covered in the project report:

- **Demand and Supply Position:** State the data regarding total expected demand of the product and present supply position. How-much of this gap will be filled up by the proposed unit?
- **Price Expected to be realized:** An estimate of the price expected should be furnished to assess the margin of profit. A comparative statement of competitor's selling price would be helpful.



- **Marketing Strategy:** What strategy for selling the products is proposed to be followed? Whether any arrangements have been made with reputed suppliers and distributors for lifting the production? Sometimes, particularly in electrical goods, owners of reputed brands may enter into contract to lift the entire production and sell it later after putting their trade mark on it.
- **After-Sales Service:** In some items it is very vital. Even due to a loose screw or snapping of a wire, the customer may find the instrument either not working or working improperly and without after-sales service. Due to this, the product gets a bad name. Normally it has been found that money spent on after-sales service by a manufacturer is repaid many times over the long run.
- **Seasonality Factor:** Whether the product has seasonal fluctuations in sales? If so, the arrangements made for warehousing or stocking of the goods in off-season should be stated.
- **Transportation:** Whether the unit will depend for the transportation of goods on public carrier or will it like to own its own transport? If own transport is needed, state the probable cost and the amount of assistance required.

**Capital Costs and Sources of Finance:** An estimate of the various components of capital items required by the unit should be given in the report. These components may be the following:

- Land and building
- Plant and machinery
- Installation costs
- Other miscellaneous assets like furniture/fixtures, vehicles, tools, dies, jigs, fixtures, patterns, types etc.
- Preliminary and preoperative expenses.
- Contingency cushion against price rise/ unforeseen expenses.
- Margin for working capital.

Besides the cost factors, the report should include probable sources of finance. These sources of funds should equal the cost of a project as otherwise the project cannot be set-up in full. The resources would include the owner's funds together with loans and deposits raised as well as the limits expected from financial institutions/banks.

The estimation of funds for the cost factors involved should be realistic and correct. Many units run into serious financial problems because of inadequate estimate of funds requirement.



**Assessment of Working Capital, Requirements:** Planning for working capital requirements is equally crucial for an entrepreneur. While estimating the capital costs, margin for working capital has taken into account. Any unit will be able to function only when adequate working capital requirements have been made and shown along with the total cost of the project.

Sometime back, formats for working capital assessment has been designed for limits up to Rs. 50,000, for limits between Rs. 50,000 and Rs. 2 lakhs and above Rs. 2 lakhs. As such if the entrepreneurs present their estimates in those prescribed formats, it will save time and energy for them as well as for the banker.

It has been generally noticed that the entrepreneurs present the working capital requirements in their own way which is ultimately recasted by the banker. This wastes time and creates problems. Hence, if they project their requirements in the prescribed way, it will minimize objections from the banker's side.

**Other Financial Aspects:** One of the objectives of setting-up a project is to earn a livelihood. Besides the project set-up must be able to retrieve the investments made within its life cycle. This would be possible only if the products taken up for production are adequately profitable. This would require preparation of a projected Profit & Loss Account which would indicate likely sales revenue, cost of production, allied cost and profit. These estimates especially the likely sales revenue, should be made on a realistic basis. A projected Balance Sheet and Cash Flow Statement would be have to prepared to indicate financial position and requirements at various stages of the project. After all, the smooth functioning of the unit necessitates availability of adequate funds for various commitments.

Next the Break-Even Analysis must be presented. Break-even point is the level of production/sales where the industrial enterprise shall make no profit no loses it will just break-even. This facilitates knowing the gestation period and the likely moratorium required for repayment of loans.

Break-even point (BEP)

Where,  $F$  = Fixed Costs

$S$  = Sales Projected

$V$  = Variable Costs



The break-even point thus calculated will show at what percentage of projected sales the units will break-even.

It is also a good idea of calculate and indicate the following ratios:

1. Profitability Ratio  $= \frac{\text{Net Profits}}{\text{Sales}} \times 100$
2. Return on Investment  $= \frac{\text{Net Profits}}{\text{Capital Employed}} \times 100$
3. Debt Equity Ratio  $= \frac{\text{Debt}}{\text{Equity}}$
4. Debt Service Coverage ratio  $= \frac{\text{Net Profit after tax} + \text{Depreciation} + \text{Interest for one year}}{\text{Installments} + \text{interest (for one year)}}$

**Economic and Social Variables:** What will be the abetment costs, i.e., cost for controlling the environmental damage (e.g., pollution)? The abetment cost will constitute the value of the additional engineering and technology needed for treating the effluents -and emissions.

Whether the project will have some socioeconomic benefits, of which the following are a few examples:

- **Employment Generating:** The number of persons proposed to be employed vis-a-vis employment situation of that area may be mentioned.
- **Import Substitution:** The manner in which it is planned to be achieved and the amount of benefit expected may be mentioned.
- **Ancillarisation:** Whether the unit will need sub-contracting functions of such type that ancillary industrial units may be promoted to meet them?
- **Exports:** Quite likely the products proposed for manufacture may be exported in full or in part.
- **Local Resource Utilization:** Certain local resources which are presently a waste may be usefully utilized upon the project going on stream.
- **Development of the Area:** How the establishment of the unit will bring on overall development in the area of its operation?





**Project Implementation Schedule:** Preferably a PERT/CPM chart can be appended to the project report. If this is not feasible then in a tabular form, likely dates of completion of the following activities can be mentioned.

Acquisition of land	Installation of plant/machinery
Registration of the unit	Recruitment of workers
Bank loans	Training of workers
Construction of building	Ordering raw materials
Power connection	Procurement of raw materials
Ordering plant/machinery	Trial run
Supply of plant/machinery	Commercial production

**Plant Layout:** If possible, a copy of the plant layout can also be furnished in the project report. This will assist determining sufficiency of area for present and future expansion programmes.

### SPECIMEN OF A PROJECT REPORT

Look at the following illustrative project report of a manufacturing unit; it will help you understand how to prepare a project report.

<b>A. PRODUCT DESCRIPTION</b>
<b>B. PRODUCTION AND GENERAL EVALUATION OF PROSPECTS</b>
<b>C. MARKET ASPECTS</b> <ol style="list-style-type: none"> <li>1. Users</li> <li>2. Sales Channels &amp; Methods</li> <li>3. Geographical Extent to Market.</li> <li>4. Competitive Situation: <ol style="list-style-type: none"> <li>(a) Domestic Market</li> <li>(b) Export Market</li> </ol> </li> <li>5. Market needed for plant described</li> </ol>
<b>D. PRODUCTION REQUIREMENT</b>



1.	Annual Capacity (One/Two/Three-Shift Operation)		
2.	Capital Requirements		
	<ul style="list-style-type: none"> <li>▪ Land &amp; Buildings on rent (Mention value, if owned)</li> <li>▪ Equipment, furniture and fittings</li> <li>▪ Working capital</li> </ul>		
3.	Total capital which the entrepreneur would need for the whole project provided he uses agencies planned by the Government for financial accommodation.		
	<ul style="list-style-type: none"> <li>▪ Own</li> <li>▪ Own Borrowings</li> </ul>		
4.	Expected net profit per annum		
<b>E. CAPITAL REQUIREMENTS</b>			
<b>I. Fixed assets &amp; working capital</b>			
(a)	Land (.....sq. meters) and	Rs.	
	Building (.....sq. meters), on rent		
	at Rs. .... per annum		
(b)	Equipment:		
	Production Equipment	(List down in an appendix,	
	giving values, etc., of each machine separately)		
(ii)	Other Tools & Equipment		
(iii)	Furniture and Fittings		
(c)	Working Capital		
	[This would be calculated keeping in view the periods in which capital on an average in various forms, i.e. manufactured goods, semi-manufactured goods, raw material etc., would remain locked up. Often you may calculate it at 3 months requirement level; unless the situation (line of industry) warrants otherwise.]		
			_____ <u>Total.</u>
<b>II. Raw Material &amp; Allied Supplies (Annual)</b>			
	Description	Qty.	Rate      Annual Requirements
1.	Raw material		



2.	Power, Fuel & water			
3.	Maintenance & Allied Supplies			
4.	Other Supplies			_____
				<u>Total</u>
III.	Manpower (Annual)			
	Description	No.	Rate (Rs.) per month	Actual Cost (Rs.)
	Manager			
	Foreman			
	Supervisors			
	Skilled Workers			
	Semi-Skilled Workers			
	Unskilled Workers			
	Office Staff			
	Others			_____
				<u>Total</u>
IV.	Other Costs (Annual)			
	(a) Depreciation on equipment, furniture & fittings.....annum			
	(b) Interest on capital (fixed and working.....per annum on average)			
	(c) Administrative Costs			
	(d) Sales cost (including sales commission, advertisement, etc.)			
	(e) Provision for discount, bad debts and miscellaneous contingencies			
	(f) Training costs.			
F.	<b>TOTAL ANNUAL COSTS, SALES REVENUE AND NET PROFITS</b>			
	(a) Annual Costs			
	▪ Rent for Land & Buildings			
	▪ Raw Materials & Allied Supplies			



- Manpower
- Other Costs
- (b) Annual Sales Revenue
- (c) Expected Annual Net Profit (b-a)
- (d) % Profit on Own Capital
- (e) % Profit on Total Annual Sales Turnover
- (f) % on Total Investment

### 7.3 Planning Commission's Guidelines for Formulating a Project Report

In order to process investment proposals and arrive at investment decisions, the Planning Commission of India has also issued some guidelines for preparing/formulating realistic industrial projects. So far as feasibility report is concerned, it lies in between the project formulating stage and the appraisal and sanction stage. The project formulation stage involves the identification of investment options by the enterprise and in consultation with the Administrative Ministry, the Planning Commission and other concerned authorities.

Realizing the usefulness of these guidelines, these guidelines are presented in a summarized manner as following:

- **General Information:** The feasibility report should include an analysis of the industry to which the project belongs. It should deal with the past performance of the industry. The description of the type of industry should be given, i.e., the priority of the industry, increase in production, role of the public sector, allocation of investment of funds, choice of technique, etc. This should also contain information about the enterprise submitting the feasibility report.
- **Preliminary Analysis of Alternatives:** This should contain present data on the gap between demand and supply for the outputs which are to be produced, data on the capacity that would be available from the projects that are in production or under implementation at the time the report is prepared, a complete list of all existing plants in the industry, giving their capacity and level of production actually attained, a list of all projects for which letters of intents/licenses have been issued and a list of proposed projects. All options that are technically feasible should be considered



at this preliminary stage. The location of the project as well as its implications should also be looked into. An account of the foreign exchange requirement should also be taken. The profitability of different options should also be given. The rate of return on investment should be calculated and presented in the report. Alternative cost calculations vis-a-vis return should be presented.

- **Project Description:** The feasibility should provide a brief description of the technology/process chosen for the project. Information relevant to determining optimality of the locations chosen should also be included. To assist in the assessment of the locations chosen should be included. To assist in the assessment of the environmental effects of project, every feasibility report must present the information on specific points, i.e., population, water, air, land, flora and fauna, effects arising out of project's pollution, other environmental discretions etc. The report should contain a list of the operational requirements of the plant, requirements of water and power, requirements of personnel, organizational structure envisaged, transportation costs, activity-wise phasing of construction and factors affecting it.

Market Plan it should contain the following items:

- Data on the marketing plan.
  - Demand and prospective supply in each of the areas to be served.
  - The method and data used for main estimates of domestic supply and selection of the market areas should be resented. Estimates of the degree of price sensitivity should be presented. It should contain an analysis of past trends in prices.
- **Capital Requirements and Costs:** The estimates should be reasonably complete and properly estimated. Information on all items of costs should be carefully collected and presented.
- **Operating Requirements and Costs:** Operating costs are essentially those costs which are incurred after the commencement of commercial production. Information about all items of operating cost should be collected; operating costs relate to the cost of raw materials and intermediates, fuel, utilities, labour, repair and maintenance, selling expenses and other expenses.
- **Financial Analysis:** The purpose of this analysis is to present some measures to assess the financial viability of the project. A proforma Balance Sheet' for the project data should be presented. Depreciation should be allowed for on the basis of specified by the Bureau of Public Enterprises. Foreign exchange requirements should be cleared by the Department of Economic Affairs. The



feasibility report should take into account income tax rebates for priority industries, incentives for backward areas, accelerated depreciation, etc. The sensitivity analysis should also be presented. The report must analyze the sensitivity of the rate of return of change in the level and pattern of product prices.

- **Economic Analysis:** Social profitability analysis needs some adjustment in the data relating to the costs and returns to the enterprise. One important type of investment involves a correction in input and costs, to reflect the true value of foreign exchange, labour and capital. The enterprise should try to assess the impact of its operations on foreign trade. Indirect costs and benefits should also be included in the report. If they cannot be quantified, they should be analyzed and their importance emphasized.
- **Miscellaneous Aspects:** The preceding three areas are deemed appropriate to almost every new small enterprise. Notwithstanding, depending upon the size of the operation and peculiarities of a particular project, other items may be considered important to be applied out in the project report. To mention, probable use of minicomputers or other electronic data processing services, cash flow statements, method of accounting etc., may be of great use in some small enterprises.

### 7.3.1 Project Appraisal

Project appraisal means the assessment of a project. It is critical and analytical evaluation of the project from different angles. While appraising a project, technical, commercial, economic, ecological, social and managerial aspects are taken into consideration. Project appraisal is usually done by a financial institution which besides making an analysis of costs and benefits of a proposed project assesses the project from the various aspects of an investment proposition before extending finance. Project appraisal is, therefore, a process whereby a leading financial institution makes an independent and objective assessment of the various aspects of an investment proposition for arriving at a financial decision and is aimed at determining the viability of a project and sometimes, also in modifying its scope and content so as to improve its viability.

A project involves employment of scarce resources. Hence, the entrepreneur has to appraise various projects before allocating the scarce resources for a project. First a project has to be appraised from economic aspects. The economic aspects of appraisal include production of goods or services, generation of additional revenue, employment of labour, better rewards for the owners of capital, etc. A



good organization is required for the implementation of the project. An entrepreneur usually has three types of organization to fall upon: sole trade proprietorship, partnership and joint stock companies. The type of organization suitable for the project has to be setup. The financial institutions have to take special care with regard to the managerial aspects of the project. The management should be competent and efficient; otherwise a good project may fail. Technical appraisal includes the location and site of the project the technology used, technical collaboration if any, capacity utilization, plant layout, project design etc. The financial appraisal should ensure that the project has a sound financial base. Analysis of cost, pricing, availability and utilization of funds, income and expenditure and fair return on investments are the areas to be covered under financial appraisal. Commercial/marketing aspects of appraisal are concerned with potential demand for the product/service, quality of product/service, price, design, marketing channels etc. Ecological and social aspects of a project have assumed much importance today. The project should be eco- friendly and should aim at society's well-being.

In short, a financial institution requires a detailed evaluation of the feasibility from the point of view of:

- Managerial Competence.
- Technical Feasibility
- Market Analysis.
- Economic Viability
- Financial Viability.
- **Managerial Competence** Successful entrepreneurs are found to be possessing managerial and entrepreneurial traits. Funding agencies would therefore, like to find out whether the individual interested in setting up the venture possesses needed managerial traits. A project report should contain information such as family background, educational qualifications, past experience of service, business or industry, interest in other firms and innovative ideas of promoters so as to enable financial institutions to assess managerial capabilities of the individual. It is not necessary that entrepreneur should possess all managerial traits and perform all the functions himself. He should either be in a position to perform all such functions himself or should be competent and resourceful enough to hire and use the required managerial resources. Project report, should therefore, mention about the managerial structure of the enterprise. It is very difficult indeed to evaluate managerial and entrepreneurial capabilities of an individual. Even if the promoter himself



wants to evaluate his capabilities the evaluation may not be very correct. It is likely to happen because of the fact that the sense of self-esteem is prevalent in every individual and it inhibits proper self-assessment.

- **Technical Feasibility:** The technical feasibility of the proposal/project contains the resource and technical analysis of the feasibility study. It deals, with the production cost of the item. If the production cost of the item is low, the item can be sold at a competitive price in relation to a similar quality product. For example, hand operated fan at cheaper cost will be economically feasible but technically unsound. The use of solar energy may be technically viable but it is not economically feasible yet because the experiment on this line has not been finalized.

Technical appraisal deals with the following components:

- Location of the unit.
  - Size of the plant.
  - Process of Manufacture.
  - Factory layout
  - Personnel.
  - Availability and cost of raw material.
  - Power and water, facilities.
  - Technological viability in the application of the finished product.
- **Market Analysis:** The success of project depends on how it is able to sell the product/service in the market. This is because marketing is the only activity which produces revenue while all other activities incur expenditure. Therefore, the product/service should be marketable. The supply and demand for the product/service have to be estimated and see whether there is any market opportunity. A detailed market analysis should be conducted covering market opportunity and strategy for converting the opportunity into a reality. It is, therefore, suggested that the report should contain the following information:
- The size and composition of the present demand.
  - Market segment (s) identified for the proposed venture (The market segmentation may be done on the basis of income, age and sex of consumers, geography of the area, etc.)





- Short and long- term demand projection of the overall market and of the segment(s) identified for the proposed project.
- The market penetration that the proposed unit is expected to achieve over the, projected period. This may be planned in view of the increasing national and international competition and changing need of the consumers.
- Broad pricing structure on the basis of which future demand has been made and market penetration ratio has been calculated.
- The strategy of marketing in the target markets.

➤ **Economic Viability:** Economic viability is an important criterion for evaluating a project. Whatever may be the motivation in starting a project from the point of view of the promoters, it shall be necessary that the operations quantified on a year to year basis should generate sufficient profits. A project without adequate profits or which is likely to incur losses, could not be classified as commercially viable. Evaluation of economic viability can be carried out through projection of profitability worked out for a period ranging from three to ten years. In case of financial applications, such projections should be carried out for a period covering the term of the loan to be negotiated with banks and financial institutions. In any case, the profitability of a project should be established on a long-term basis, keeping in view a spread of five years after a reasonable level of capacity utilization is achieved.

A Projected Profitability Statement has to be prepared by taking into account-capacity utilization and all costs, it shall be necessary to proceed further and calculate certain ratios to evaluate the economic viability of the project. Some of the ratios are debt service coverage ratio, payback period, average rate of return, net present value, break-even sales and internal rate of return. The format of the Profitability Statement is given below:

#### Projected Profitability Statement

Rs. in Lakhs										
Years										
	1	2	3	4	5	6	7	8	9	10
Production during the year- Value										- Quantity
Utilization of installed capacity - %										



<b>A. Sales</b>		
(1)	Sales including all miscellaneous receipts.	
(2)	Less Excise	_____
(3)	Net Sales (a)	_____
<b>B. Cost of Production</b>		_____
(4)	Raw materials consumed	
(5)	Power and fuel	
(6)	Direct labour and wages	
(7)	Consumable Stores	
(8)	Repairs and maintenance	
(9)	Other manufacturing expenses	
(10)	Depreciation	_____
	Total (Cost of production) (b)	_____
(11)	And Opening Stock in process and finished goods.	_____
(12)	Deduct Closing Stock in process and finished good	
<b>C. Cost of Sales (c)</b>		
<b>D. Gross Profit (a-c)</b>		
<b>E. Interest</b>		
	▪ On term loan from Institutions and Banks	
	▪ On Working capital loans	
	▪ On other borrowings	
<b>F. Selling, General and Administrative Expenses</b>		
<b>G. Profit before Taxation</b>		
	[D-(E+F)]	
<b>H. Provision for Taxes</b>		
<b>L. Net Profit (G - H)</b>		
<b>J. Depreciation Added Back</b>		
<b>K. Net cash Accruals</b>		
<b>L. Repayment Obligations</b>		_____



▪ Towards Institutions and Banks	_____
▪ Towards Others	_____
TOTAL REPAYMENT	_____
<b>M. Debt/Service Ratio L: K</b>	
<b>N. Contribution A – [(4+6+7)]</b>	
<b>O. Break-even Value of Sales</b>	

**Financial Viability:** The appraisal of the financial aspects involves scrutiny of:

- Cost of the project and means of financing.
- Cash flow estimates.
- Project balance sheets.
- **Cost of the Project and Means of Financing:** The financial plan for meeting the cost of the project depends on how accurately the cost is estimated. The estimate will have to provide for:
  - Land and site development
  - Plant and machinery.
  - Buildings.
  - Technical –know how fees.
  - Miscellaneous fixed assets.
  - Preliminary expenses.
  - Pre-operative expenses.
  - Provision for contingencies.
  - Margin money for working capital.

Cost of the project having been accurately estimated, sources of finance should be identified. This is in the form of own funds and borrowed funds. Borrowed funds also referred to-as debt consists of term loans, deferred payment guarantees, public deposits, debentures etc. The debt-equity proportion of 2:1 should be generally adhered to.

**Cash Flow Estimates:** A cash flow statement is a projection of future sources of cash and their application. In the cash flow statement, profit is the most important source of inflow and profit depends on how accurately the costs of production and sales estimated have been arrived at. Profit that is



considered as an inflow could increase or decrease depending on management policies followed in the borrowing units. This is referred to as personal judgment concept. For example, if there is a change in the method of inventory valuation, the profit would rise or fall. This does not indicate a corresponding increase or decrease in cash flows.

**Debt Service Coverage Ratio (DSCR):** The DSCR establishes the relationship between net profits and the repayment of term loan and interest thereon. It is calculated as:

$$\frac{\text{Net Profit after Tax} + \text{Interest on term Loan} + \text{Depreciation}}{\text{Term Loan Installment} + \text{Interest on Term Loan}}$$

A ratio of 2:1 is considered satisfactory, indicating that even if only, 50% of the net profits are earned; still repayment of installments of term loan and interest would not pose a problem.

**Projected Balance Sheets :** Projected balance sheets are to be prepared for each of the years covering the entire period of the term loan. The projected balance sheets report the effect of the plan of operations on the assets, liabilities and capital of the business unit. In analyzing the projected balance sheets, attention is to be focused on the movement of funds and also analysis its impact of the term loan granted by the financial institution on the assets and liabilities of the business unit.

A project should comply with all the above broad feasibility/viability criteria. However a project report need for necessarily cover all the above aspects. The depth and coverage of the above feasibility aspects could be planned in accordance with the purpose of preparation of the report and the size of investment in the project. Normally, discounted cash flow and calculation of economic rate of return are avoided in case of small scale projects. The detailed market survey is required only when the products to be manufactured have fierce competition. Therefore, prior to preparation of project report one need to consider the purpose of project report and the cost of its preparation. In case of a tiny project an expenditure of even two thousand rupees on preparation of project report may look quite high. For such projects one should attempt to prepare a project report covering, entrepreneurial capabilities, demand for the product(s), and managerial, technical and financial viability. It may not cost too much to the entrepreneur and at the same time it will serve the desired purpose. In case of bigger projects the project report should contain all those details which have been discussed in this lesson.



A project report is not a document covering precise details especially in respect of financial and economic viability. It is essentially a projection of performances based on certain assumptions. Most of the long-term projections have some weaknesses and suffer from limitations. Similarly, project report may have certain limitations and should be used carefully.

### 7.3.2 Common Errors in Project Formulation

Project formulation is as important as not so easy. However, the entrepreneurs often make errors while formulating project reports or business plans.

The errors widely noticed in project formulation are:

**Product Selection:** It is noticed that some entrepreneurs commit mistakes by selecting a wrong product for their enterprises. They select the product without giving due attention to product for their enterprises. They select the product without giving due attention to product related other aspects such as size of the product markets, its future demand, competitive position, lifecycle, availability of required labour, raw material and technology. Hence, when you are selecting a product, take a comprehensive view.

**Capacity Utilization Estimates:** The entrepreneurs usually make over-optimistic estimates of capacity utilization. Their estimates are based on completely false premises. The estimates are made in complete disregard of present-enterprise performance, prevailing market conditions, competitive atmosphere, the technical snags, etc. A business plan formulated as such falls prey to financial jugglery. Hence, avoid such temptations while estimating capacity utilization for your enterprise.

**Market Study:** Product production is ultimately meant for eventually sale. Hence, market study of the product assumes importance. Market study continues to be a grey area. But, there are some entrepreneurs who pass by this component of their business plan completely. Based on their nebulous ideas and scanty and scattered information on demand and supply of their proposed product, they conclude that market is just there waiting to be tapped. This is a wrong attitudinal block. Avoid it.

**Technology Selection:** The requirement for technology differs from product to product depending upon the nature of products. Swayed by the reported profit margins, the entrepreneurs sometimes plan for a technology not possible to set up within limited financial resources. Thus, in the absence of



technological feasibility, enterprise is foredoomed to failure. Hence, make sure your technological feasibility.

**Location Selection:** The entrepreneur often makes two types, of errors while selecting location for their enterprises. First, they are completely swayed by the Government offer of financial incentives and concessions to establish industries in a particular location. This becomes their sole and overriding concern completely disregarding other factors like market proximity, availability of raw materials, manpower and infrastructural facilities. Second, the entrepreneurs select a location for their enterprises merely because it is their home town or they own ancestral land there which is, however, to an appropriate location. Make sure you do not fall prey to such temptations.

**Selection of Ownership Form:** Many enterprises fail merely because the ownership form of enterprises is not suitable. Hence, select a suitable form of ownership taking a comprehensive view of the factors affecting the selection of a form.

The project report/business plan is a blue-print of all those activities that an entrepreneur proposes to engage in. It is not only a guide for business' activities, but also an essential exercise for developing cost and benefit estimates resources planning and feasibility testing of the proposed business activity. The project report is required for purposes of obtaining funds from the financial institutions and banks. The project report for an entrepreneur is what a guide map is for a traveler. In order to complete the project within a stipulated period and cost, all activities involved in the project are scheduled in a sequential relationship called network or scheduling of activities. The common errors made by the entrepreneurs while formulating project reports/business plans are also highlighted.

## 7.4 Check Your Progress

1. Which one of the following is the stage of Project Life Cycle?

- (a) The Pre-investment stage
- (b) The Construction stage
- (c) The Normalization stage
- (d) All of the above

2. Which one of the following is a type of sectoral project?

- (a) Industry and Mining Sector



- (b) Agriculture and Allied Sector
  - (c) Irrigation and Power Sector
  - (d) All of the above
3. Which one of the following is a significance of project report?
- (a) It helps in establishing techno-economic viability of the project.
  - (b) It helps in approaching bank for getting working capital loan.
  - (c) It helps in securing supply of scarce raw materials.
  - (d) All of the above
4. A project report includes.....?
- (a) Location of the project
  - (b) Availability of raw material
  - (c) Both a & b
  - (d) None of the above
5. Which one of the following includes in the guidelines of formulation of Project report?
- (a) Preliminary Analysis of Alternatives
  - (b) Capital Requirements and Costs
  - (c) Both a & b
  - (d) None of the above
6. A project report is a report which provides all the necessary information of the unit proposed to be set-up for the manufacture of a product or rendering a service. Is it true?
- (a) Yes
  - (b) No
  - (c) Cannot say
  - (d) None of the above

## 7.5 Summary



Project is a cluster of activities where resources are invested from its inception to its completion to generate a given result within a framework of approved time and cost schedules. Each stage of the project cycle plays an important role in the systematic project planning process.

Project identification is the first and most crucial stage of project cycle. Entrepreneur has several investment opportunities but he is supposed to select only a few potential projects for preliminary evaluation. The identification of a project provides only the green signal for the preparation of feasibility report for appraisal and investment decision. Project formulation is the systematic development of a project idea by evaluating its various components to take an investment decision. An entrepreneur is expected to involve himself in only those projects which are technically sound, financially feasible, economically beneficial, commercially dependable and organizationally effective and adequate.

Project appraisal is a method of presenting a choice amongst competitive usage of resources in a convenient and comprehensive fashion to achieve the laid down objective of the economic development plan. A project report enables the entrepreneur to know how much money, manpower and material would be required to set up the project, type of machine and technology required and the economic gains from the project.

## 7.6 Keywords

- **Project:** It is a single use plan and aimed at achieving a specific one time goal.
- **Project Report:** It is a written document pertaining to any investment proposal.
- **Project Identification:** It is concerned with the collection, compilation and analysis of economic data for the eventual purpose of locating possible opportunities for investment and with the development of the characteristics of such opportunities.
- **Project Formulation:** A process in which an entrepreneur is required to undertake an objective assessment of different dimensions of an investment proposition of project idea.
- **Feasibility Study:** A formal investigation of profitable opportunities which leads to rational decisions about making an investment decision.
- **The Pre-investment Stage-**It covers setting of aims and objectives, forecasting of demand, selection of best alternatives.





- **The Construction Stage**-Resources are assembled and all these resources are allocated to develop or create a tangible project which is ready to achieve the set objectives.
- **The Normalization Stage**-The allocated resources of assets (created during the second stage) are utilized or employed to produce the end results.
- **Utilities:** Water, power, steam, compressed air requirements, cost estimates, sources of utilities.
- **Working Capital:** Funds that are needed to run day to day operations of a business.

### 7.7 Self-Assessment Test

- Define the term 'project'. How will you classify the projects?
- Define a project report. Why is a project report prepared?
- What do you mean by project identification? Discuss the process involved in project identification?
- What are the contents of a project report? Prepare a project report for starting a small scale soap manufacturing unit.
- While adjudging the viability of your proposed project, what factors you will take into consideration.

### 7.8 Answers to check your progress

- 1(d), 2 (d), 3(d), 4 (c), 5(c), 6 (a)

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<b>SELECTION OF FACTORY LOCATION</b>	

## Structure

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## 8.9 References/Suggested Readings

## 8.0 Learning Objectives

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

- Describe the process of selecting a suitable location for an enterprise.
- Discuss the various theories of location of business enterprises.
- Explain the factors which affect industrial location.
- Highlight the Government policy on industrial location.

## 8.1 Introduction

One of the most important decisions which must be made when a new enterprise is to be established is the choice of its location. There may be many desirable locations from which to make a selection, but in all probability there will be a few sites which are more suitable than the others. In most instances, the three major factors that enter directly into location selection - raw materials, transportation facilities, and qualified labour-must be present in the right combination. In other instances, nearness to other plants, supply of cheap fuel, power, and water, the attitude of local government may be more important. It is impossible to rank these factors in order of importance, since for one type of enterprise nearness to raw materials may be the most important consideration, and for another type availability of transportation facilities may take precedence. The best location is the one that provides a good balance among all these factors.

## 8.2 Process of Selecting a Suitable Location

The process of selecting a suitable location for an enterprise involves the following three different steps:

**First Step:** This step relates to selection of the region in which the enterprise is to be suited. As per this step decision is to be taken about the State or District where the organisation is to be located. For instance, with reference to India, the State in which the plant is to be located may be Delhi, Punjab, West Bengal, Rajasthan, etc.



**Second Step:** After the selection of the region, the decision relating to a particular community, in which the plant is to be located, is to be taken by the entrepreneur. For example, if according to the first step, Delhi is selected, community may refer to any part of Delhi, East, West, North or South.

**Third Step:** This step pertains to the selection of the plant site where the plant is to be situated. Continuing with the example of Delhi as region and North Delhi as community, the factory may be set up in Narela or industrial area of Wazirpur. We have to identify exact plot number, where the plant is to be installed at this stage.

Since the selection of location of business enterprise involves the above three stages, it is called a “Three-Step Process”. The above mentioned three different aspects of a location problem are not unrelated phases which can be completely divorced from each other and treated separately. In fact, they are related to each other; the presence or absence of suitable sites influences the selection of a community, and the existence of suitable communities in various regions affects region comparisons. Thus, the locational problem may be approached by comparing regions, communities, and sites in that order, and as long as the analyst is constantly aware of the interdependence of the three levels of study, the results are likely to be quite satisfactory.

### 8.2.1 Theories of Location of Business Enterprises

Proper location of any business enterprise is essential for its success. The cost of production may differ from location to location and, therefore, it is necessary to find out a site where the cost of production is the lowest. In deciding about the location of an enterprise, the theories developed by economists may be of help to the entrepreneurs. The various theories of industrial location are discussed below:

**Traditional Approach of Classical Economists:** Classical economists like Adam Smith, J. S. Mill, Alfred Marshall, etc. were the first who thought about the problem of industrial location. However, they did not make any significant contribution in this respect. They pointed out that the selection of location was based on factors like availability of raw material, personal choice due to local loyalty of the entrepreneur market and skilled labour. The analysis of these economists was based on empirical studies and scientific treatment of the problem was lacking. They could not evolve any persuasive theory of location.



**Weber's Theory:** Prof. Alfred Weber's original work was published in German language in 1909; but it became popular when it was translated into English in 1929. His method of treatment is purely deductive and the entire theory is based on the study of general factors which pull an industry towards different geographical locations.

**Assumptions:** Weber's theory is based on the following assumptions:

- The centers of consumption are fixed.
- The cost of raw materials in spite of uneven distribution of deposits of raw materials is same at all places.
- The centers of labour supply are fixed and have unlimited supplies of labour at constant cost.
- Transportation costs are determined by weight to be transported and distance to be covered. Impliedly, transportation-rates are equal throughout the country and there is an absolutely even plane.

Weber classified the factors influencing the location into two broad categories, viz., (a) *primary factors* which influence the regional distribution of industry, and (b) *secondary factors* which determine the redistribution of industries within a particular region by the process of agglomeration and deglomeration.

- **Primary Factors:** These factors influence the location of plants over different regions. Weber identified cost of land and building, machines and other fixed assets, cost of materials, power and fuel, cost of labour, cost of transportation, and interest and depreciation charges as the factors that cause regional distribution of industries. Costs of land and buildings have an insignificant influence on location as their proportion to other inputs is very small. Differences in the cost of raw materials are largely due to varying distances over which they are to be carried and may, therefore, be treated as a form of transport cost. Depreciation and interest costs are independent of geographical location and have no significant bearing on industrial location: Therefore, Weber developed his theory on the basis of two regional factors, namely (a) transportation costs; and (b) labour costs.
- **Transportation costs:** An enterprise has to incur transportation cost to carry raw material to the plant and to carry the finished product to the market. A plant tends to be located at a site where



the total cost of transportation of materials and production is minimum. According to Weber, transportation costs are determined by two factors, namely the weight to be transported and the distance to be covered. The weight of materials depends upon the nature of raw materials and the type of transformation in the process of production. Weber classified raw materials in two categories- ubiquitous materials and localized materials. *Ubiquitous materials* are available everywhere e.g., water, sand, clay, brick etc., while localized materials are confined to particular regions e.g. coal, iron-ore, cotton, cement etc. *Localized materials*, exercise considerable influence on industrial location but ubiquitous materials are insignificant.

However, the influence of localized materials varies according to their behaviour in the process of production. On this basis localized materials may be further sub-divided into two categories, namely pure and gross materials, Pure or non-weight losing materials are those which do not lose much of their weight in the process of production e.g. cotton, wool, iron-ore. Such materials do, not pull plants to their place of deposit because the cost of transportation remains the same for both raw materials and finished products. Gross or weight-losing materials impart a small part or none of their weight to the finished product, e.g. sugarcane and coal. Such materials attract production towards places of their deposits as the weight of materials to be transported in many times more than the weight of the finished product. Therefore, industries like sugar which use gross raw materials tend to be located near the source of materials e.g. sugarcane farms.

On the basis of above reasoning, Weber developed a mathematical formula to measure the relative pull of materials “and the market on industrial location. He called this ratio ‘material index’ which ‘can be calculated as follows:’

$$\text{Material Index} = \frac{\text{Weight of localized material}}{\text{Weight of the finished product}}$$

Industries with a high material index more than one tend to be located near the source of materials while those with a low materials index less than one are attracted towards the market. According to Weber “the material index measures the total weight to be moved in a locational figure per unit of product and is termed as ‘locational weight’ of the respective industry. All industries whose material index is not greater than one and whose ‘locational weight’, therefore is not greater than two, lives at the place of



consumption". A plant may be attracted towards the centre of consumption when ubiquitous materials add substantially to the weight of the product.

- **Labour costs:** Another primary factor which influences the location of industries is the availability of cheap labour. A plant may deviate from the point of least transportation cost when the savings in labour cost are greater than the additional cost of transportation at the new centre. Points of equal deviation from the place of minimum transportation cost can be measured by '*Isodapanes*'. Isodapanes represent points of equal transportation cost including assembling cost of materials and distribution cost of finished product. One of these points may touch a cheaper labour centre and may just correspond with the economies of labour on the one hand and the additional transportation cost on the other. It is called the critical isodapane. If the actual labour centre lies within the area of such a critical isodapane, then migration of the industry takes place as it will result in greater economy in labour cost than the extra transportation cost involved.

The pull of labour depends upon labour cost per unit of product and location weight. Labour cost per unit of finished product is measured by *labour cost index* i.e., to the weight of the product. Location weight, as stated above, is the weight to the transported during the process of production. To measure the attracting power of labour, Weber gave the following formula:

$$\text{Labour Coefficient} = \frac{\text{Labour cost index}}{\text{Locational weight}}$$

Higher the labour coefficient, greater is the tendency for a plant to be located near the centre of cheap labour supply.

- **Secondary Factors:** Deviation from the minimum transport advantage point or the optimum labour cost point also takes place due to the operation of secondary factors. The factors that cause either the concentration or the dispersal of industries are grouped under this head. The factors of concentration or '*agglomerative factors*' as called by Weber include better facilities of banking credit, communication, insurance, transport, etc. The agglomerative factors are also known as 'external economies'.

The factors that cause dispersal of industries are known as '*deglomerative factors*' as per Weber's theory. These factors are also known as 'external diseconomies'. The diseconomies' like rise in rents,





rate, taxes, etc. high cost of labour, high cost of land, housing problems etc. accelerate the process of geographical dispersal of industries.

Weber also examined the possibility of more than one site of location for an industry. If production consists of two or more processes and each one is carried out independently of others, it is possible to have a split in location of industry. Such location is profitable only when a material used in the first stage loses a substantial proportion of its weight in the first process of manufacture. In this case, the first process must be localized near the sources of raw materials, while the second and latter processes have no economic attraction to be associated, with the first. For example, in the paper industry, pulp is manufactured near the forests, i.e.; the sources of raw, materials and paper from the pulp is manufactured near the markets.

**Critical Appraisal of Weber's Theory:** Weber's theory of industrial location has been criticized on the following grounds

- The theory is based on unconvincing, oversimplified, and impractical assumptions. *Firstly*, the assumption that there are fixed points of consumption does not accord well with the market conditions in a competitive structure. Austin, Robinson points out that, in reality, there is a widespread market served by competing producers. Consuming populations is usually scattered over the whole country and the consuming centres may be shifting with a shift in industrial population. *Secondly*, his assumption with regard to transport cost is not realistic. He based the transport cost on weight and distance. However, in reality, the transport costs vary according to the type of transportation, the quality of goods to be transported, the topography and character of the region, etc. *Thirdly*, the fixed centres of cheap labour are a myth today. Labour has become considerably mobile and attracted towards the location of industries rather than the industries going towards the cheap labour. Moreover, the second assumption about labour: centres that each centre has unlimited supply of labour is even more objectionable because unlimited supply of labour cannot be envisaged at any centre.
- Weber takes into consideration only two factors viz. transport and labour, and completely ignores so many other factors of location such as availability of fuel and power, water supply, climate,



historical and political factors, taxation policy etc. which also influence, to a great extent, on the selection of the location.

- The classification of material into ubiquitous-and fixed material is considered artificially by Austin Robinson. He points out that, in actual practice, materials are drawn from a large number of alternative fixed points and, therefore, the classification of materials into ubiquities and fixed materials appears to be artificial.
- Weber's approach, as pointed out by S.R. Dennison is overburdened with technical considerations. Costs and prices which must form the basis of any such theory are not given proper treatment and the theory is full of technical coefficients. "As a matter of fact, the investigations of an economist ought to be based mainly on the considerations of costs and prices". Weber's analysis ignores all factors of costs and prices and this is the most important criticism of his deductive theory.

In spite of the above criticism, Weber's theory of location is an important milestone in economic history; it is first scientific attempt that provided systematic explanation for a complicated problem of the theory of location. It should, therefore be not discarded, in toto; it needs modification by giving up the unrealistic assumptions and by making it more comprehensive.

**Sargant Florence Theory:** Prof. Sargant Florence evolved an inductive theory for explaining the causes of industrial location. He found that the problem of industrial location is more related to the distribution of occupied population of the country than to its geographical areas. His theory of location is based on two new concepts -location factor and co-efficient of localization.

- **Location Factor:** It is an index of the degree of concentration of an industry in a particular region. This index is calculated by taking the percentage of all workers in a particular industry found in a certain region and dividing it by the proportion in that particular region of the total industrial workers in the country. Where an industry is evenly distributed throughout the country, the location factor for each region would be unity. If the industry is not evenly distributed, the location factor will be either above unity or below unity. Regions showing location factors above unity or below unity would indicate that such regions have a higher share or a lower share of the industry than what should have been the case. The calculation of location factor may be explained by an example given below:

**Example 1**

Total number of workers employed in all the industries in the country	10 lakhs
Total member of workers in textile industries	1 lakh
Total number of workers in Western region	4 lakhs
Total number of workers employed in textile industry in Western region	0.5 lakh

So Location Factor

Percentage of workers in textile industry to all  
workers in that industry in the Western region

Percentage of workers in the Western region  
to total industrial workers in the country

$$= \left\{ \frac{0.5 \text{ lakh}}{1 \text{ lakh}} \right\} \times 100 \gg \left\{ \frac{4 \text{ lakh}}{10 \text{ lakh}} \right\} \times 100$$

$$= 50 \gg 40$$

$$= 1.25$$

The location factor in this case is a bit higher than one which means that textile industry has higher share in that region i.e. there is greater concentration of textile industry in the Western region.

- **Coefficient of Localization:** It indicates the tendency of a particular industry to concentrate or disperse anywhere in the country. It can be obtained for an industry by dividing the positive or negative deviations of the regional proportion of workers in the particular industry from the corresponding regional proportion of workers in all industries by 100. Industries which are concentrated in certain region will have high co-efficient of localization; and industries which are dispersed in different regions will have low co-efficient of location. By calculating the coefficients of locations for all industries, they can be divided into the categories of high, medium and low co-



efficient industries. Accordingly, the locational significance of an industry can be shown and the problem of investigation can be made easier. A low co-efficient of localization for a particular industry indicates that it can easily thrive in various regions. On the other hand, industries with high co-efficient of location have a tendency to get centralized in particular regions only. Thus, co-efficient of localization showing the tendency towards concentration or dispersal is helpful in regional planning of industries in a country. The computation of coefficient of locations is illustrated below:

### Example 2

Total number of industrial workers in a country	10 lakhs
Total number of workers in the Southern region	3 lakhs
Total number of workers in the Eastern region	2 lakhs
Total number of workers in the Western region	4 lakhs
Total number of workers in the Northern region	1 lakhs

Total number of workers in sugar industry is 2 lakhs, distributed in the four regions as follows

Southern	0.5 lakh
Eastern	0.25 lakh
Western	1 lakh
Northern	0.25 lakh

The computation of the coefficient of localization is shown in the following table:

Regions	Percentage of workers the region to all workers in the country	Regional percentage of workers in the sugar industry in the region to all workers in the textile industry	Deviations
Southern	30	25	+5
Eastern	20	12.5	10
Western	40	50	10



Northern	10	12.5	-2.5
	Sum of plus deviations =	12.5	
	Co-efficient of location =	$\frac{12.5}{100} = 0.125$	
		100	

The co-efficient of localization in the above illustration is very low which implies that the industry can easily flourish in different regions and does not indicate signs of concentration.

**Critical Appraisal of Florence's Theory:** The inductive theory of location given by Prof. Florence has been criticized on the following grounds:

- The two statistical indices developed by Prof. Florence are just descriptive and not explanatory of prescriptive. "They explain the existing state of distribution of industries in a country. They cannot explain the reasons for a particular form of concentration or dispersal. They do not even clarify the question or a correct allocation of Industries among various regions.
- The location factor, which is determined only on the basis of the number of industrial workers working in an industrial area is an inadequate criterion of concentration. Critics argue that a better basis can be provided by the volume or value of output of industries in the area.
- The co-efficient of localization reflects the pattern of industrial distribution which may vary from country, to country. Thus, it is difficult to judge about the concentration of industries merely on the basis of the co-efficient of localization. At best, it can have the verifiable value.

In spite of the above criticisms, the indices developed by Prof. Florence play an important role in studying the locational dynamics in any country. They serve as invaluable guides for analyzing the trends of industrial growth in a country.

**New Balanced Approach:** Balanced regional economic growth of a country is the need of the hour. To achieve the objective of balanced regional development, a realistic policy of locational planning based on comprehensive theory needs to be formulated. With regards to this, a significant contribution was made by Ohlin, Losch, Palander and others who evolved a theory of location on increasingly comprehensive basis. In their analysis, they endeavored to establish an interrelationship between factors like economic differences, cost differences, human differences, national characteristics and various



political, geographical and transportation barriers. In fact, all locations are interdependent and mutually affect each other. Therefore, the study of locational dynamics should be based on broader economical social and strategic considerations rather than being dominated by limited economic considerations alone.

### 8.2.2 Factors Affecting Industrial Location

As already discussed, the process of selection of a suitable location for an industrial enterprise involves these steps (1) selection of the broad region in which the plant is to be located; (2) choice of the community inside that region; and (3) decision about the specific site where the plant is to be situated. The factors affecting plant location are discussed as under:

#### Factors Affecting Selection of Region

While making a choice of a suitable region for a proposed industrial enterprise, the following factors must be most searchingly considered with due regard to the nature of the industry:

- **Availability of Raw Material:** In the selection of plant location, the availability of raw material is an important factor; because the cost of raw material forms, a substantial part of the total cost of production. The localized gross materials have got an important influence on the concentration of an industry. Ubiquities may not have major influence over it. Often a factory is situated near the source of raw materials which are weight-losing or gross or bulky or heavy in nature. For example, sugar industry in India is located in U.P. and Bihar where sugarcane is grown. Similarly, jute industry was attracted, near the source of its raw materials near Calcutta.
- **Accessibility to the Market:** Since goods are manufactured with the object of selling them in the market, an easy access to the market becomes an important consideration in the choice of an industrial location. Industries whose products are costly to carry on account of fragility, perishability, or bulk are located in close proximity, to market. This tendency becomes more emphasized if the raw materials are less costly to transport or are derived from diverse sources, and lose little weight in the manufacturing process Evolution of new markets is an important factor. For example, jute industry has shown a dispersal tendency due to the creation of new markets in U.P., Bihar and Tamil Nadu arising from the demand of bags for new industries like sugar, flour and cement.



- **Availability of Labour:** Labour is probably the most important single factor influencing plant location. Industries in general and labour-intensive industries in particular, which need manual workers in large numbers, have a tendency to be located in those areas where the supply of labour is easy and wages are low. However, recently labour has become mobile to a great extent and, therefore, it is available in most of the regions of the country. Further, with the growth of trade unions and after the awards of industrial tribunals, the wage-factor has lost much of its importance in determining location.

Labour's attitude towards work and its contribution to productivity exert the major influence today. On the whole, industrial relations are more disturbed in some region than in others. The particularly hostile attitude of labour force in certain states or regions acts as an important deterrent to the setting up of industries there.

- **Transport and Communication Facilities:** Transport facilities *i.e.* storage, handling and service facilities play an important role in the location of any manufacturing undertaking; as raw materials must be brought to the factory and the finished products must be dispatched economically and without undue delay. In some industries where raw materials form a major item of cost, cheap and easy transport facilities become an important consideration. In others, where the raw materials are bulky and their transportation relatively costly, it would be an advantage to have the works located close to the source of supply in order to facilitate transport activities and maintain the transportation charges at their lowest possible level. That is why steel and iron works are to be found near coal and iron producing areas. Thus, an entrepreneur may try to establish the factory where the transportation cost may be the minimum but there may be deviations from this; because the point of minimum transport cost may not be the point of minimum production cost. However, today the increased flexibility and efficiency of modern forms of transport have enabled entrepreneurs to exercise a freer choice in the matter of location than in the past.

In general, for operating an industrial plant successfully, management must be informed on market situations as regards raw materials, finished goods, supplies and market prices. Up-to-date information can be had only when there are communication facilities. Here lies the importance of this factor in determining the plant location.



- **Supply of Cheap Fuel, Power and Water:** The factor of cheap and easy supply of fuel and power must also enter into the question of the choice of site as the item reflects itself in the final cost of products. In the past, coal had an unrivalled sway over the industrial growth in a country. At present, there are, however, several other sources of power, e.g., electricity, gas, oil and waterpower. As electric power can be carried to great distance from its sources, industries today have been somewhat free in choosing their locations throughout the country. Coal as source of power has maintained position in those cases, where carbon content becomes necessary; but in other cases alternative sources of power are making rapid headway. However, it is the cost factor that decides the form of power as influences the location of industrial enterprises.

The importance of water varies from industry to industry. If it is used only for drinking and sanitary purposes, obviously, it is of little or no consideration. In many industries, however, such as steel, paper and chemicals, water is a highly important locational factor. For example, 65,000 gallons of water are required to produce a ton of steel and 2, 00,000 gallons for a ton of viscose rayon. Many companies not only require large quantities of water but also need a relatively pure supply, both of which restrict location.

- **Natural and Climatic Considerations:** The factors like the level of ground, the topography of a region, drainage facilities, disposal of waste products and climate, etc., may also affect location of a manufacturing enterprise. Extractive industries like coal, iron ore and bauxite are located within fairly narrow limits fixed by natural conditions. Climate also plays an important role. For example, dry climate is essential for flour milling industries etc. and therefore, they are located in Kanpur, Poona which do not have damp climate. Similarly, for cotton textile industry, humid climate is important; as under such climate the frequency of yarn breakage is low. However, the effect of climate has been modified to a great extent in many industries by artificial methods such as dehumidification, air-conditioning, etc. The advantages of moist climate in spinning enjoyed by Bombay, for example, have been nullified by the artificial methods of humidification.

Climate influence the efficiency of employees too. A cool invigorating climate attracts industries; because workers can work harder there. It is also congenial for managerial staff.





- **Personal and Historical Consideration:** Sometimes enterprises are located at particular places on account of the personal preferences and prejudices of the entrepreneurs concerned. For instance, Henry Ford established automobile industry in Detroit because it was his home town. Lord Nuffield founded Morris Motors in Coerley, South-East of Oxford, because the school in which his father was educated happened to be for sale.

Similarly, industries grow in certain places on historical grounds. It is said that the cotton industry “first settled in Lancashire because the woolen industry was already there, foreigners were kindly received and Manchester was not a Corporation”. In India, many industries were pioneered in the Presidency towns because it is there that the British settled first.

- **Momentum of an Early Start:** When a few industries are set up in an area, transport facilities, particularly railway stations come up there, banks open branches, repairs and maintenance shops are opened and, even, townships grow. All these provide a momentum to the future establishment of industries in the areas. For example, Durgapur Steel Plant may be the biggest industrial unit in Durgapur but many other industries have also been set up in wake of the establishment of the Steel Plant.
- **Political and Strategic Considerations:** Recently, political and strategic considerations also have been influencing the selection of a region where the business is to be located. Lack of political stability in a particular state stands in the way of establishment of industrial enterprises and/or drives away those already established, as has happened in West Bengal, Punjab and Jammu and Kashmir.

Strategic considerations are particularly important for those industries which produce materials ‘for war and products of national importance. Such industries are main targets of air-attack and, therefore, should be located at places which are relatively immune from air-attackers. For instance, India’s aircraft factory is located in Bangalore and her main arsenal is situated in Jubbulpore; both the places are relatively safe from enemy invasion.

- **Government Policy:** In planned economies like India, governments play an important role in location of industries. Such governments often encourage setting of industrial enterprises in the backward regions, by means of subsidies, tax-rebates, provision of easy finance, transport facilities, etc. This policy helps in achieving balance regional development throughout the country. Recently,



many state governments in India are attracting industrial entrepreneurs, by offering them various incentives like, land and power at concessional rates, tax-rebates, etc. to speed up the tempo of industrialization in their respective states.

- **Financial Facilities:** Finance is the life-blood of any industrial enterprise. Therefore, the availability of adequate finance at cheaper rates influences the consideration about its location to some extent. However, the financial facilities are not likely to exercise much influence on location decision; because capital is highly mobile. Under certain special circumstances, this factor may become important. For instance, the Government of India encouraged special financial institutions like ICICI, IDBI, IFCI etc. to provide more funds at cheaper rates to under developed regions of the country so as to attract industries to those regions. With the same purpose, the nationalized commercial banks are also encouraged to open more branches in such areas.
- **Miscellaneous Factors:** The decision about industrial location may be affected by numerous other factors which may not be reducible to economic terms in strict sense of the term. “Police and fire protection, recreational and social facilities of the community, schools and colleges for employees and their children, housing, trends of local land values, telephone service, and the nearness of complementary or service plants, should all have a bearing on executive decisions”. Any one of these factors may assume dominating proportions in a particular case.

To sum up, while selecting a region for the location of an industrial enterprise, besides the above mentioned factors, special care should be given to long-range forecasts of future operating needs and techniques; because locating a plant is a long run proposition. An anticipated expansion of the concern, diversification of the product, future market, shifts in raw materials etc. have a pronounced influence on locating an industrial enterprise. Although every long-range factor cannot be foreseen, but wise planning dictates that every foreseeable change be included in the considerations at the time of locating an enterprise.

### Factors Affecting Selection of Community

After the selection of the most suitable general region, the selection of a community within that region is to be done. For this purpose, a community which fulfils the following conditions will be more suitable in determining the location of an industrial enterprise:



- There should be adequate labour-supply both in quantitative and qualitative terms.
- The prevailing wage-rates in the same industry should be reasonable; they should not be too high to make the manufacturing activities uneconomical.
- The general attitude of the community towards industry must be co-operative. A community with a record of illegal strikes is likely to be a wrong selection.
- The existence of other complementary or supplementary enterprise in the community with respect to raw materials, products, labour demands, etc. will be helpful to the new enterprise.
- There should be absence of laws and ordinances having an adverse effect on operational efficiency and tax burden should be moderate.
- The living conditions in the community should be favorable so that the employees at levels get proper social life.

### **Urban Vs. Rural Community**

While selecting a particular community, an entrepreneur has to make a choice between urban and rural community. Both have their relative advantages as well as disadvantages which are given below:

### **Relative Advantages and Disadvantages of Urban Location**

#### **Advantages**

- An urban location is well-connected with different modes of transport.
- It offers excellent facilities for communication.
- Power and water supplies are easily available.
- Facilities for repairs and maintenance are better.
- The adequate supply of unskilled and skilled labour-force is available.
- The allied and subsidiary industries are present in plenty.
- There are better living conditions for all levels of employees.
- Large local market for the products manufactured is available.



- The services of experts are easily available.
- Financing institutions such as banks, underwriting houses and special financial institutions are nearby.

**Disadvantages**

- Cost of land and construction of building on it is high.
- Land suitable for a large-scale unit is difficult to get and is usually, limited in area; if available.
- Due to the high cost of living in urban area, labour wages are also high.
- Local taxes and rents tend to increase making the costs of operation higher.
- Employee-employer relations are often tense.
- Provision of housing accommodation for the staff proves very costly.
- Expansion of the industry because of high costs is seldom possible.
- There are many restrictions imposed by local municipality regarding disposal or affluent water, wastes etc.

**Relative Advantages and Disadvantages of Rural Location or Sub-Urban Location****Advantages**

- Land cost is low and is available in plenty for construction of building and also for expansion.
- Labour costs are proportionately lower as compared to that of urban locations.
- Employee-employer relations are friendlier and there are no union problems.
- Taxes are low.
- Several governmental incentives may be available; because it wants the balanced development in all areas.
- There is absence of undesirable municipal restrictions on the manufacturing units.
- There is lower cost of living for the employees.

**Disadvantages**

- There is shortage of skilled labour and managerial personnel.
- There is lack of transport and communication facilities.
- Power is often not available.
- Rural areas are far away from markets,
- The medical, educational and amusement facilities are not available.
- It is difficult to get ancillary services.
- There are difficulties in procurement of materials.

**Factors Affecting Selection of Site**

Having selected a community in which the plant is to be located, the final decision concerns the choice of an exact site within the community. The following are the main considerations to be given in the selection of a site:

- The size of the plot should be large enough not only to accommodate the present requirements but also for future expansion within the next one or two decade.
- The load bearing capacity of the land of site should be sufficiently strong so that heavy building may be built. Facilities for water and power should be available.
- Similarly, facilities for sewage and effluent disposal must be available.
- The site chosen should have easily approachable roads and rail links.
- The initial cost of the land and its development costs also affect the decision relating to choice of site. Sometimes, low priced land may turn out to be very expensive; if heavy development costs are to be incurred.

**Determination of Optimum Location**

Selecting a location requires consideration of costs and revenues. Each location can be shown to have both fixed and variable costs associated with its use. The cost of land and buildings are considered fixed



over relatively wide ranges of output, while labour, material transportation and power charges are expected to vary with the output level. Naturally, some of the expense items for anyone location will be higher than similar costs at other locations, while other expense items will be lower.

In addition to costs and revenue, the more intangible factors such as community attitudes, community facilities, employee housing, etc. must be either evaluated subjectively or given an estimated value for the purpose of determining an exact location.

### Example 3

Location A would result in annual fixed costs of Rs. 3, 00,000, variable costs of Rs 63 per unit, 1 and revenues of Rs. 68 per unit. Annual fixed costs at location Bare Rs. 8, 00,000, variable costs are Rs. 32 per unit, and revenues are Rs. 68 per Unit. Sales volume is estimated to be 25,000 units per year.

The additional data, not reducible to rupee figures, relating to the two locations are as follows:

Locations		
	A	B
Community attitude	Wants business	Indifferent
Community facilities	Very good	Good
Employee housing	Excellent	Good

**Which location is more attractive on the basis of annual costs? Which site is better on overall basis?**

**Solution:** Table showing comparative Profitability of Locations

Alternative Locations		
	Location A (Rs.)	Location B (Rs.)
<b>Revenue (i)</b>	<b>17,00,000</b>	<b>17,00,000</b>
<b>Costs :</b> Variable	15,75,000	8,00,000
Fixed	3,00,000	8,00,000



<b>Total Cost (ii)</b>	<b>18,75,000</b>	<b>16,00,000</b>
<b>Profit (Loss) (i-ii)</b>	<b>(1,75,000)</b>	<b>1,00,000</b>

On the basis of costs, Location B is more attractive, even though annual fixed costs are much higher than for A. However, if we include the impact of intangible factors - community attitude, community facilities and employee housing also, the location B may not necessarily be obvious choice.

In the process of identifying evaluating alternatives, management must consider the behavioral implications of location also. The revenues of many service organisations depend upon a location featuring customer convenience. Organisations having less direct contact with the consuming public must recognize potential difference in employee behaviour among various locations. Differences in life-styles and values are necessarily carried over into the workplace, and these differences affect on the job behaviour.

At the international level, production managers must recognize that locating in another country involves more than a simple transplanting of technology, and that they must try to uncover hidden behaviorally problems. Cultural differences, for example, may inhibit efficient operations.

### 8.3 Government Policy on Industrial Location

#### 8.3.1 Need for Government Policy

If industrial location is governed solely by considerations of economic efficiency it may give rise to several socio-economic evils. Therefore, planned and regulate location of industries is necessary. In the absence of Government controls, private industrialists are likely to set up industries in already developed areas resulting in lopsided development of the country. Government policy on industrial location is needed.

- To ensure balance regional development of the country;
- To develop local resources;
- To make efficient utilization of national resources,
- To ensure equitable distribution of employment opportunities;



- To achieve 'equitable distribution of income and wealth;
- To remove poverty and to improve living standards in backward regions; and
- To speed up industrial developments.

### **8.3.2 Problem of Concentration**

In India there has been concentration of industries in general as well as in particular due to uneven distribution of natural resources in different parts of the country and absence of any Government control on location before independence. In general, four States namely Maharashtra, West Bengal, Gujarat and Tamil Nadu account for more than one-third of the total industrial development in the country. In particular, there has been heavy concentration of certain industries in some States. For instance, the jute industry is localized in West Bengal, sugar industry in Uttar Pradesh and Bihar, cotton textile industry in Maharashtra and Gujarat etc.

Concentration of industries leads to several economic and social evils. It results in gross inequalities in the distribution of income and wealth. People living in backward areas are deprived of equal employment opportunities. Excessive concentration of industries puts undue strain on housing, transport and other public services and results in wide regional disparities in the standard of living. Concentration of industries creates problems of housing, transport, slums, health, traffic congestion, pollution etc. It also poses a danger to the country's defense.

### **8.3.3 Balanced Regional Development - Need of the Hour**

From the foregoing discussion, it is clear that the tendency to concentrate industries in a few places is associated with several social and economic evils. To obviate these evils, the tendency to concentrate industries must be reversed. For economic growth and equitable distribution of income and wealth, it is essential that industrial activity should be distributed evenly throughout the economy. Thus, the balanced regional development is expected to yield the following benefits:

- It helps in the reduction of regional disparities in the distribution of income and wealth.
- It leads to an equitable distribution of employment opportunities.
- It facilitates a more even development of the local resources of the country as a whole.





- It ensure for more efficient utilization of economic resources.
- It helps in removing poverty in backward areas and, thus, helps in increasing the standard of living of the people.
- It protects industries from external attack.
- It helps in reducing the social problems like slums, overcrowding, traffic congestion; etc.

To sum up, to overcome the problems of concentration of industries in few places and to reap the benefits, of balanced regional development, it is necessary that the location of industries be regulated and controlled. Here lies the need for Government policy on location of industries.

#### 8.3.4 Government Policy of Industrial Location

The industrial location may be, controlled by the Government of a country by adopting a ‘two-fold approach’. The first fold consists of positive measures to encourage establishment of industries in certain areas and the second fold relates to negative measures to discourage establishment of industries in certain other areas.

**Positive Measures:** The positive measures include incentives given to industries being established in certain areas. In general, to ensure balanced regional development the country, the positive measures are more effective than the deterrents. The incentives and facilities provided by the Government may include the following:

- Provision of basic infrastructure like transport and communication network, water, power, fuel etc. in backward regions.
- Provision of socio-economic amenities like education, health, recreation, training, marketing facilities for local industries with a view to develop backward areas.
- Granting of tax concessions to industrial units established in specified backward areas.
- Granting or subsidies: The subsidies may be direct as well as indirect. Direct subsidies may take the form of subsidized prices, supply of raw materials, tools and equipment at concessional prices, etc. Indirect subsidies may be in the form of reducing, the cost of certain services or to offset the effect of unfavorable factors in industrially backward areas. For example, a transport subsidy, which



consists of a grant of 50 percent of the transport cost on raw materials, is given to industrial units established in the hilly areas of Assam, Jammu and Kashmir, Meghalaya, Nagaland, Manipur, Tripura, etc.

- Assurance by the Centre of State Government(s) to buy the finished products of the industrial units set up in backward parts of the country.
- Provision of finance at concessional rates of interest to industrial units established in backward districts.
- Issue of licenses liberally and on a preferential basis for setting up plants in backward regions.
- Establishment of industrial estates in industrially backward regions. The main purpose of creating such states is to enable a large number of small scale units to have the advantage of common services and facilities provided by the Government.

**Negative Measures:** The negative measures include deterrents in the form of restrictions and disincentives designed to discourage establishment of new industrial units in concentrated areas. The deterrents may take the following forms:

- Enhancing rates of local taxes in concentrated areas. To prevent excessive concentration of industries in certain areas, taxes may be imposed on the industrial units for the benefit of the new units in backward areas.
- Taking up licensing policy which discourages establishment of new units in concentrated areas. According to Industries (Development and Regulation) Act, 1951, industries covered under the Act are required to obtain an industrial license for starting a new unit and also for substantial expansion of an existing unit. The licensing authorities, while granting license ensure that the backward areas get their due share of industrial development and the new enterprise does not disturb the regional balance.
- Passing laws prohibiting establishment of any new industries in certain areas. For example, as per the Industrial Policy, 1977, no more licenses are to be issued for establishing new industrial units within specified limits of big cities having a population, as per 1971 census, of more than 10 lakhs and urban areas having a population of more than 5 lakhs.



### 8.3.5 Policy Measures on Industrial Location in India

Before independence, the Government did not give any attention to the balanced regional development of the country. The entrepreneurs were free in selecting locations for their plants. They selected locations on the basis of economic considerations alone; and due to that the industrial plants got concentrated in a few selected regions like Bombay, Calcutta, Ahmedabad, Madras, etc.

After independence, the announcement of the Industrial Policy in 1947 fixed the overall responsibility on the Government for the planned development of industries and their regulation in the national interest.

Consequently, the Industries (Development and Regulation) Act, 1951, was passed. This Act requires an industrialist to get a license before he starts a new plant. While granting the license, the Licensing Committee, set up under the Act, is required to consider the suitability of the location and ensure that regional balance is not upset by new industries. While granting a license, it is always kept in mind that industrially backward areas get their proper share in industrial development. Also, further concentration of already congested areas is avoided.

The Industrial Policy Resolution, 1956 stressed the importance of balanced regional development and emphasised the progressive reduction of disparities in the levels of development between different regions. The entire country can attain higher standard of living by securing a balanced and coordinated development of industrial and agricultural economy in each region. For this purpose, the Resolution suggested, among others, for the provision of positive facilities to areas which are lagging behind industrially. The Policy also emphasised the establishment of Industrial Estates which were likely to help in the decentralization of industrial activity.

The Industrial Policy Resolution of 23rd December, 1977 stated that “the Government attached great importance to balance regional development of the entire country so that disparities in the levels of development between different regions are progressively reduced”. With a view to prevent concentration of industries around metropolitan and urban centres, it was decided that no more licenses are to be issued for setting up industrial units in metropolitan cities with population of more than 10 lakhs and urban areas having a population of more than 5 lakhs as per the 1971 census. It was also declared that the State Government and financial institutions would be requested to deny support to



‘new industries in these areas such as those which do not require an industrial license. The Central Government would also consider the provision of assistance for helping existing large industries to move out of congested areas.

The Industrial Policy Statement, 1980 reiterated Government’s commitment to balanced regional development of the country and emphasised the crucial role of industrialization and the importance of dispersal of industries. As’ per the Policy Statement, the Government has decided to encourage dispersal of industry and setting up of units in industrially-backward areas, and to offer special concessions and facilities for this purpose which will be growth and performance-oriented. The Industrial Policy aimed at correction of regional imbalances through a preferential development of industrially backward regions. The Industrial Policy suggested a regular periodic assessment of the impact of incentives to determine the extent to which such incentives have fulfilled the objectives.

The Sixth Five Year Plan (1980-85) reiterated the need for “a progressive education in regional inequalities in the pace of development and in the diffusion of technological benefits”. The Government initiated the backward areas development scheme in order to minimize regional disparities in terms of location of industries. As per this scheme, the Central and State Governments identify “no industry districts” and offer incentives to private entrepreneurs for starting industries in these districts. The Seventh Plan also showed a growing concern over the undue growth of so many regions in preference to others and the resulting regional imbalances in industrial development of the country.

The Government liberalized its industrial licensing policy on 1st May, 1990. Accordingly, “all new units up to an investment of Rs. 25 crores in fixed assets in non-backward areas and Rs. 75 core in centrally notified backward areas will be exempted -from the requirements of obtaining license”. This policy, thus, aimed at motivating industrialists to start large scale units in backward areas notified by the Central Government.

The Eighth Five Year Plan has stressed the development of industrial infrastructure in backward areas. As per the Industrial Policy, 1991, there is no requirement of Governmental approval for the location of projects except in case of 23 cities each with a population of more than one million. The emphasis of 1991 Policy is also on the decentralization of industries. The concessions available in the backward



areas will continue. For setting up new units in hilly and backward areas, the entrepreneurs are offered Investment Subsidy by the Central Government.

To sum up, the balanced regional industrial development of the country is need of the hour. We must have equitable distribution of industries in all areas. Government regulations and policy always favor decentralization of industries, and, particularly, development of backward regions to bring about industrial and commercial growth.

### **8.3.6 Industrial Estates**

An industrial estate or an industrial park is an area that has been specially designed so that factories can be built there. The idea of industrial estate is borrowed from the United Kingdom for the encouragement of industrial growth in selected areas. It is an institutional arrangement for building up basic infrastructure and common services facilities for the development of industrial units. All utility services such as water, electricity, transport, drainage, are readily available to all units at low or even subsidies rates. External economies of scale of operations are available from the establishment and development of industrial estates.

#### **Objectives of Industrial Estates**

The Government of India set up the Small Scale Industries Board in 1955 which proposed the idea of establishing industrial estates with the following objectives:

- Promotion of small and medium-sized industries in the backward areas.
- Removal of congestion in the industrial areas of metropolitan towns,
- Achievement of balanced regional development through decentralization of industry, and
- Growth of ancillary industries in the townships surrounding major industrial units.

#### **Advantages of Industrial Estates to Entrepreneur**

An industrial estate offers the following benefits to the entrepreneurs:

- It offers industrial sites at low rates. They need not incur special cost of survey, or finding a suitable-location of the factory.



- At utility services like water, electricity, drainage etc. and common service facilities like testing centres, industrial training workshops, insurance etc. are readily available to all the units normally, at subsidized rates.
- Each member unit enjoys protection and security from the promoters of such estates.

Besides being useful to the entrepreneur; an industrial estate is advantageous to the community also. It helps in increasing employment opportunities. It facilitates balanced growth of all regions. It adds to revenues of public authorities and helps in raising standard of living of the People. Thus, it is instrumental in removing poverty.

Lastly, in pioneering and establishment of projects of industrial estates, extraordinary care and precautions must be taken. The honesty and sincerity must prevail at all stage of the projects so that the entrepreneurs are in a position to get best out of these and, subsequently, are in a position to offer the best to the society.

## 8.4 Check Your Progress

1. Which of the following explain the need for facility location selection?
  - (a) When the existing business unit has outgrown its original facilities and expansion is not possible.
  - (b) When a business is newly started.
  - (c) When the lease expires and the landlord does not renew the lease.
  - (d) All of these.
2. Which of the following is the first step in making a correct location choice?
  - (a) Develop location alternatives
  - (b) Decide the criteria for evaluating location alternatives
  - (c) Evaluate the alternatives
  - (d) Make a decision and select the location
3. Which of the following technique emphasizes transportation cost in the determination of facility location?
  - (a) Location rating factor technique
  - (b) Transportation technique



- (c) Centre-of-gravity technique
  - (d) Both (b) and (c)
4. Transportation cost mainly depends on which of the following factors?
- (a) Distance
  - (b) Weight of merchandise
  - (c) Time required for transportation
  - (d) All of the above
5. In which of the following site selection techniques, a weightage between '0' to '1' is provided to factors that influence its location decision?
- (a) Location rating factor technique
  - (b) Transportation technique
  - (c) Centre-of-gravity technique
  - (d) None of these
6. Which of the following does not cause to production delay?
- (a) Shortage of space
  - (b) Long distance movement of materials
  - (c) Spoiled work
  - (d) Minimum material handling

## 8.5 Summary

Location of an enterprise is an important entrepreneurial decision as it affects the operational as well as financial performance. There may be many desirable locations from which to make a selection, but in all probability there will be a few sites which are more suitable than the others. In most instances, the three major factors that enter directly into location selection - raw materials, transportation facilities, and qualified labour-must be present in the right combination. So entrepreneur is required to identify that location at which the enterprise will have easy access to physical, economic and social endowments. Selecting a location requires consideration of costs and revenues. Each location can be shown to have both fixed and variable costs associated with its use. The cost of land and buildings are considered fixed over relatively wide ranges of output, while labour, material transportation and power



charges are expected to vary with the output level. Naturally, some of the expense items for anyone location will be higher than similar costs at other locations, while other expense items will be lower.

In deciding about the location of an enterprise, the Traditional Approach of Classical Economists, Weber's Theory, Sargant Florence Theory and New Balanced Approach may be of help to the entrepreneurs. There are some important factors which are normally to be considered when selecting the location of an enterprise. Industrial location has received closer attention of the Government and policy planners in recent times. For economic growth and equitable distribution of income and wealth, it is essential that industrial activity should be distributed evenly throughout the economy. Industrial estate is an institutional arrangement for building up basic infrastructure and common service facilities for the development of industrial units.

## 8.6 Keywords

- **Market Index:** The weight of localized material divided by weight of the finished product.
- **Labour Coefficient:** It is labour cost index divided by locational weight.
- **Coefficient of Localization:** It indicates the tendency of a particular industry to concentrate or disperse anywhere in the country.
- **Industrial Estate:** It is an area that has been specially designed so that factories can be built up there.
- **Industrial Policy:** It is strategic effort of a country to encourage the development and growth of all or part of the economy mainly the manufacturing sector.
- **Balanced Regional Development:** It indicates utilization of development potential of all areas as per its capacity so that the benefit of overall economic growth is shared by the inhabitants of all the different regions of a country.
- **Transportation cost:** The expenses a company incurs when it transfers its inventory or other assets to another location.
- **Variable cost:** A variable cost is a corporate expense that changes in proportion to production output.
- **Fixed cost:** business costs, such as rent, that are constant whatever the amount of goods produced.





- **Decentralization:** the transfer of control of an activity or organization to several local offices or authorities rather than one single one.

### 8.7 Self-Assessment Test

- What do you understand by a suitable location? Explain its importance with reference to a new manufacturing enterprise.
- What is Weber's theory of location? Discuss the grounds on which the theory is criticized.
- Write a critical note on Sargent Florence's theory of location.
- Explain the need of Government policy on location of industries. What are the objectives of Government's interference in location of industries?
- What factors should be taken into account in deciding the location of the following:
  - A sugar mill and A textile mill

### 8.8 Answers to check your progress

- 1(d), 2 (b), 3(c), 4 (d), 5(a), 6 (d)

### 8.9 References/ Suggested Readings

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<b>DEMAND ANALYSIS AND MARKET POTENTIAL MEASUREMENT</b>	

## Structure

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## 9.0 Learning Objectives

After reading this lesson, you will be able to:

- Explain the key steps in demand analysis.
- Define the concept of Demand Forecasting.
- Describe the term Market Planning.
- List out the steps which are to be undertaken for measuring the market potential of a particular product.

## 9.1 Introduction

Demand analysis is concerned with two broad issues: What is the likely aggregate demand for the product/service? What share of the market will the proposed project enjoy? Intelligent and meaningful answers to them call for an in-depth study and assessment of various factors like patterns of consumption growth, income and price elasticity of demand, composition of the market, nature of competition, availability of substitutes, reach of distribution channels etc.

## 9.2 Steps in Demand Analysis

Given the importance of demand analysis, it should be carried out in an orderly and systematic manner.

The key steps in such analysis are as follows:

- Situational analysis and specification of objectives
- Collection of secondary information
- Conduct of market survey
- Characterization of the market
- Demand forecasting
- Market planning

### 9.2.1 Situational Analysis and Specification of Objectives

In order to know the relationship between the product and its demand, entrepreneur may informally talk to customers, competitors, middlemen, and others in the industry. Situational analysis generates enough



data to measure the market. To get a reliable handle over projected demand and revenues, a formal study need not be carried out, particularly' when cost and time considerations so suggest. To carry out such a study, it is necessary to spell out its objectives clearly and comprehensively. Often this means that the intuitive and informal goals that guide situational analysis need to be expanded and articulated with greater clarity. A helpful approach to spell out objectives is to structure them in the form of questions. In doing so, always bear in mind how the information generated will be relevant in forecasting the overall market demand and assessing the share of the market the project will capture. This will ensure that questions not relevant to market and demand analysis will not be asked unnecessarily.

To illustrate, suppose that data is to be gathered about food processor based on a new principle that appears to offer several advantages over the conventional mixie. The entrepreneur needs information about where and how to market the food processor. The objectives of market and demand analysis in this case may be to answer the following questions:

- Who are the buyers of mixie?
- What is the total current demand for mixie?
- How is the demand distributed temporally (pattern of sales over the year) and geographically?
- What is the break-up of demand for mixie of different sizes?
- What price potential customers are convinced about the superiority of the food processor?
- How can potential customers be convinced about the superiority of the food processor?
- What price and warranty will ensure its acceptance?
- What channels of distribution are most suited for the food processor? What trade margins will induce distributors to carry it?
- What are the prospects of immediate sales?

### 9.2.2 Collection of Secondary Information

In order to answer the questions listed while delineating the objectives of the market study, information may be obtained from secondary and/or primary sources. Secondary information is information that has



been gathered in some other context and is already available. Primary information, on the other hand, represents information that is collected for the first time to meet the specific purpose on hand. Secondary information provides the base and the starting point for demand analysis. It indicates what is known and often provides leads and cues for gathering primary information required for further analysis. This section looks at the secondary information and the following at the primary information.

#### 9.2.2.1 General Sources of Secondary Information

- **Census of India:** A decennial publication of the Government of India, it provides information on population, demographic characteristics, household size and composition.
- **Economic Survey:** An annual publication of the Ministry of Finance, it provides the latest data on industrial production, wholesale prices, consumer prices, exports, agricultural production, national income, etc.
- **Guidelines to Industries:** An annual publication of the Central Statistical Organization, it contains information on various aspects of industry: number of units and state-wise distribution, average number of working days, employment, materials consumption, quantity of products, etc.
- **Annual Reports of the Development Wing, Ministry of Commerce and Industry:** An annual publication, it gives a detailed review of industries under the purview of the wing. It also provides information about new items manufactured for the first time in India and the list of protected industries.
- **Annual Bulletin of statistics of Exports and Imports:** An annual publication of the Ministry of Commerce, it provides data on imports and exports for a very large number of items and as per international classification.
- **Monthly Studies of Production of Selected Industries:** A monthly publication of the Central Statistical Organization, it provides all India data on production, number of units installed capacity, state-wise break-up, stock level, etc., for several selected industries.
- **Publications of Advertising Agencies:** The leading advertising agencies like Clarion, McCann and Thompson have published test markets, marketing rating indices of towns of India, consumer index of markets, and other studies which throw valuable light on Indian markets.

#### 9.2.2.2 Evaluation of Secondary Information



While secondary information is available economically and readily, its reliability, accuracy, and relevance for the purpose under consideration must be carefully examined. The analyst should seek to know:

- Who gathered the information? What was the objective?
- When was the information gathered? When was it published?
- How representative was the period for which the information was gathered?
- Have the terms in the study been carefully and unambiguously defined?
- What was the target population? How was the sample chosen?
- How representative was the sample?
- How satisfactory was the process of information gathering?
- What was the degree of sampling bias and non-response bias in the information gathered?
- How accurately was the “information edited, tabulated, and analyzed”?
- Was statistical analysis properly applied?

### 9.2.3 Conduct of Market Survey

Secondary information, though useful, often does not provide a comprehensive basis for demand analysis. It needs to be supplemented with primary information gathered through a market survey, specific to the project being appraised.

The market survey may be a census survey or a sample survey. In a census survey the entire population is covered. The word ‘population’ refers to the totality of all units under consideration in a specific study. Census surveys are employed principally for intermediate goods and investment goods when such goods are used by a small number of firms. In other cases, a census survey is very costly and may also be infeasible. For, example, it would be inordinately expensive—may be impossible—to cover every user of Lux soap or every person in the income bracket of Rs. 5,000-Rs. 10,000.

Due to the above mentioned limitations of the census survey, the market survey, in practice, is typically a sample survey. In such a survey a sample of the population is studied/ observed and relevant



information is gathered. On the basis of such information, inferences about the population may be drawn.

The information sought in a market survey may relate to one or more of the following:

- Total demand and rate of growth of demand
- Demand in different segments of the market
- Income and price elasticity of demand
- Motives for buying Purchasing plans and intentions
- Satisfaction with existing products Unsatisfied needs
- Attitudes toward various products
- Distributive trade practices and preferences
- Socio-economic characteristics of buyers

#### 9.2.3.1 Steps in a Sample Survey

Typically, a sample survey consists of the following steps:

- **Define the Target Population:** In defining the target population the important terms should be carefully and unambiguously defined. The target population may be divided into various segments which may have differing characteristics. For example, all television owners may be divided into three to four income brackets.
- **Select the Sampling Scheme and Sample Size:** There are several sampling schemes: simple random sampling, cluster sampling, sequential sampling, stratified sampling, systematic sampling, and non probability sampling. Each scheme has its advantages and limitations. The sample size has a bearing on the reliability of the estimates-the larger the sample size, the greater the reliability.
- **Develop the Questionnaire:** The questionnaire is the principal instrument for eliciting information from the sample of the respondents. The effectiveness of the questionnaire as a device for eliciting the desired information depends on its length, the types of questions, and the wording of questions. Developing the questionnaire requires a thorough understanding of the product/service and its usage, imagination, insights into human behavior, and familiarity with the tools of descriptive and



inferential statistics to be used later for analysis. It also requires knowledge of psychological scaling techniques if the same are employed for obtaining information relating to attitudes, motivations, and psychological traits. Industry and trade market surveys, in comparison to consumer surveys, generally involve more technical and specialized questions.

Since the quality of the questionnaire has an important bearing on the results of market survey, the questionnaire should be tried out in a pilot survey and modified in the light of problems/difficulties noted.

- **Recruit and Train the Field Investigators:** Recruiting and training of field investigators must be planned well. Great care must be taken for recruiting the right kind of investigators and imparting the proper kind of training to them. Investigators involved in industry and trade market survey need intimate knowledge of the product and technical background particularly for products based on sophisticated technologies.
- **Obtain Information as per the Questionnaire:** Respondents may be interviewed personally, telephonically, or by mail for obtaining information. Personal interviews ensure a high rate of response. They are, however, expensive and likely to result in biased responses because of the presence of the interviewer. Mail surveys are economical and evoke fairly candid responses. The response rate, however, is often low. Telephonic interviews, common in western countries, have very limited applicability in India because telephone tariffs are high and telephone connections are few.
- **Scrutinize the Information Gathered:** Information gathered should be thoroughly scrutinized to eliminate data which is inconsistent and is of dubious validity. For example, a respondent with a high income and large family may say that he lives in a one-room house. Such information, probably inaccurate, should be deleted. Sometimes data inconsistencies may be revealed only after some analysis.
- **Analyze and Interpret the Information:** Information gathered in the survey needs to be analyzed and interpreted with care and imagination. After tabulating it as per a plan of analysis, suitable statistical investigation may be conducted, wherever possible and necessary. For purposes of statistical analysis, a variety of methods are available. They may be divided into two broad categories: parametric methods and non-parametric methods. Parametric methods assume that the





variable or attribute under study conforms to some known distribution. Non-parametric methods do not presuppose any particular distribution.

Results of data based on sample survey will have to be extrapolated to the target population. For this purpose, appropriate inflationary factors, based on the ratio of the size of the target population to the size of the sample studied, will have to be used.

The statistical analysis of data should be directed by a person who has a good background in statistics as well as economics.

It may be emphasized that the results of the market survey can be vitiated by: (i) non-representativeness of the sample, (ii) imprecision and inadequacies in the questions, (iii) failure of the respondents to comprehend the questions, (iv) deliberate distortions in the answers given by the respondents, (v) improper handling of the interviews by the investigators, (vi) cheating on the part of the investigators, (vii) incorrect and inappropriate analysis and interpretation of data.

#### 9.2.4 Characterization of the Market

Based on the information gathered from secondary sources and through the market survey, the demand for the product/service may be described in terms of the following:

- **Effective Demand in the Past and Present**-The effective demand in the past and present can be gauged with the formula as given below:

$$\text{Production} + \text{Imports} - \text{Exports} - \text{Changes in stock level}$$

- **Breakdown of Demand**-To get a deeper insight into the nature of demand, the aggregate market demand may be broken down into demand for different segments of the market. Market segments may be defined by (i) nature of product (ii) consumer group, and (iii) geographical division.
  - **Nature of Product:** One generic name often subsumes many different products: steel covers sections, rolled products, and various semi-finished products; commercial vehicles cover trucks and buses of various capacities and so on.
  - **Consumer Groups:** Consumers of a product may be divided into industrial consumers and domestic consumers. Industrial consumers may be subdivided industry wise. Domestic consumers may be further divided into different income groups.



- **Geographical Division:** A geographical breakdown of consumers, particularly for products which have a small value-to-weight relationship and products which require regular, efficient after-sales service is helpful.

Segmental information is helpful because the nature of demand tends to vary from one segment to another (the demand from consumers in high income brackets may not be sensitive to price variations whereas the demand from consumers in low income brackets may be very sensitive to price variations) and different marketing strategies may be appropriate to different market segments.

- **Price-**Price statistics must be gathered along with statistics pertaining to physical quantities. It may be helpful to distinguish the following types of prices: (i) manufacturer's price quoted as FOB (free on board) price or CIF (cost, insurance, and freight) price, (ii) landed price for imported goods, (iii) average wholesale price, and (iv) average retail price.
- **Methods of Distribution and Sales Promotion-**The methods of distribution may vary with the nature of product. Capital goods, industrial raw materials or intermediates, and consumer products tend to have differing distribution channels. Likewise, methods used for sales promotion (advertising, discounts, gift schemes, etc.) may vary from product to product.

The methods of distribution and sales promotion employed presently and their rationale must be specified. Such a study may explain certain patterns of consumption and highlight the difficulties that may be encountered in marketing the proposed products.

- **Consumers-**Consumers may be characterized along two dimensions as follows:

Demographic and sociological	Attitudinal
Age	Preferences
Sex	Intentions
Income	Habits
Profession	Attitudes
Social background	Responses



- **Supply and Competition**-It is necessary to know the existing sources of supply and whether they are foreign or domestic. For domestic sources of supply, information along the following lines may be gathered: location, present production capacity, planned expansion, capacity utilization level, bottlenecks in production, and cost structure.

Competition from substitutes and near-substitutes should be specified because almost any product may be replaced by some other product as a result of relative changes in price, quality, availability, promotional effort, and so on.

- **Government Policy**-The role of government in influencing the demand for a product may be significant. Governmental plans, policies, legislations, and fiats which have a bearing on the demand of the product under examination should be spelt out. These are reflected in: production targets in national plans, import and export trade controls, import duties, export incentives, excise duties, sales tax, industrial licensing, preferential purchase, credit controls, financial regulations, and subsidies/penalties of various kinds.

### 9.2.5 Demand Forecasting

After gathering information about various aspects of demand from primary and secondary sources, an attempt may be made to estimate future demand. Demand forecast is an estimate of sales in monetary or physical units for a specified future period under a proposed business plan or programme or under an assumed set of economic and other environmental forces, planning premises outside the business organization for which the forecast or estimate is made.

An efficient demand forecast helps the management to take suitable decisions regarding plant capacity, raw-material requirements, space and building needs and availability of labour and capital. Production schedules can be prepared in conformity with demand requirements minimizing inventory, production and other related costs.

Demand forecasting also helps in evaluating the performance of sales department. Thus demand forecasting is a necessary and effective tool in the hands of the management of an enterprise to have finished goods of right quality and quantity at right time with minimum cost.



Management experts have developed many forecasting techniques to help managers handle the increasing complexity in management decision making. It is a tricky and experimental process. No one method of forecasting can be applied to all enterprises. In many cases the decisions are based on a combination of several, if not all, of these approaches. Final forecast generally include the contributions of many men of varied experience. The use of particular-method depends upon the nature of the enterprise, the products manufactured, information system in use etc.

Forecasts may be derived by means of sophisticated analysis .or they may be the result of intuition. Organizations commonly use following methods for demand forecasting:

- **Qualitative Methods:** These methods rely essentially on the judgment of experts to translate qualitative information into quantitative estimates. The important qualitative methods are as follows:
  - **Jury of executive opinion method:** This method calls for the Pooling of views of a group of executives on expected future sales and combining them into a sales estimate.
  - **Delphi method:** This method involves converting the views of a group, of experts, who do not interact face-to-face, into a forecast through an interactive process.
- **Time Series Projection Methods:** These methods generate forecasts on the basis of an analysis of the historical time series. The important time series projection methods are as follows:
  - **Trend projection method:** The trend projection method involves extrapolating the past trend into the future. The methods under this category are based on the assumption at future events are a continuation of the past. In other words, historical data can be used to predict the future. A firm accumulates data on its sales at different points of time in the past. If this firm has been in existence for some arrangement of this data (time-wise) gives a time series. A time series is the measurement of a variable (say, sales, production or profit) over time. This data can then be used to forecast sales (or demand) in future by projecting the past trend into future. Popularity of these methods rests on the fact that these are simple, inexpensive and quick methods of forecasting. These methods yield reasonably accurate results so long as the trend of the data has a persistent tendency to move in the same direction. But if the data shows significant turns then the time series analysis may not give acceptable results.



- **Exponential smoothing method:** Exponential smoothing is a very popular approach for short-term forecasting. This method determines values by computing exponentially weighted system. The weights assigned to each value reflect the degree of importance of that value. More recent values being more relevant for forecasting, these are assigned greater weight than previous period values. It may be noted that weights ( $w$ ) are so assigned that  $w$  lies between zero and unity ( $0 \leq w \leq 1$ ).

To describe the process of exponential smoothing, let  $Y$  be the observed value of the series at time  $t$ , and  $S_t$  is the smoothed value at time  $t$ . The smoothing scheme begins by setting smoothed value equal to observed value for the first period ( $t=1$ ):

$$S_1 = Y_1$$

and for any succeeding time period  $t$ , the smoothed value  $S_t$  is found with help of the equation:  $S_t = wy_t + (1-w)S_t$

That is,  $\left[ \text{Current smoothed value} \right] = w \cdot \left[ \text{Current observed value} \right] + 1-w \cdot \left[ \text{Previous smoothed Value} \right]$

This is the basic equation of exponential smoothing. The weight ' $w$ ' is also called smoothing constant. In the exponential smoothing scheme, the contribution of remote values to  $S_t$  becomes less at each successive time period. However, the rate at which this contribution declines depends on the value of  $w$ . If value of  $w$  is near 0 the impact of remote values dampens slowly, while if  $w$  is near 1 it dampens out quickly. Though the rigorous mathematical technique of selecting the best value of ' $w$ ' is beyond the scope of the lesson, rule-of-the-thumb may be prescribed for its selection:

- When the magnitude of the random variations is large, give a lower value to  $w$  so as to average out the effects of the random variation quickly;
  - When the magnitude of the random variation is moderate, a large value is assigned to the smoothing constant  $w$ .
- **Moving average method:** Moving average are smoothed values of time series. These averages are derived by averaging the value of series over successive time intervals. The illustration below



gives the 3-yearly moving average of sales of a company (col. 4). Let  $S_t$  represent the actual sales during year  $t$ . The average sales of the first years have been founded as:  $B(S_1 + S_2 + S_3) = B$   
 $\times 132 = 44$ .

Year	Sales (Rs. '000) Totals	3 – Yearly Moving Average (Trend Value)	3-yearly
1977	30	-	-
1978	42	$30+42+60=132$	44
1979	60*	$42+60+72+=216$	58
1980	72	$60+72+84=216$	72
1981	84	$72+84+92+=248$	82.7
1982	92	$84+92+100+=276$	92
1983	100	$92+100+112=304$	101.3
1984	112	$=338$	112.7
1985	126	$=378$	126
1986	140	$=414$	138
1987	148	$=452$	150.7
1988	164	$=492$	164
1989	180	$=534$	178
1990	190	$=574$	191.3
1991	204	$=614$	204.7
1992	220	—	—



Since the average represents the interval of 3 years the average value is centered at the middle of the interval (i.e., the moving total and moving average are listed against the 2nd year in the Table and in the figure accompanying the Table). If we call this average as  $S_2$ , then  $S_2=44$ . By shifting the interval forward by one year each time, we can compute moving average for successive years. For example, the second interval of 3 years is

$$S_2 = \frac{B(S_2 + S_3 + S_4)}{3} = \frac{B \times 174}{3} = 58$$

Further, the third interval, fourth interval, etc. would be

$$S_3 = \frac{B(S_3 + S_4 + S_5)}{3} = \frac{B \times 216}{3} = 72$$

$$S_4 = \frac{B(S_4 + S_5 + S_6)}{3} = \frac{B \times 248}{3} = 82.7$$

And so forth. The moving-average formula can be written in a simplified form (known as recursive form).

$$S_t = \frac{S_{t-1} + \text{Next observation} - \text{most remote observation}}{M}$$

Where,  $S_t$  is the moving average at time point  $t$ ;

$M$  is 'the interval of time taken for averaging (for example 3 year in the above illustration).

If we look carefully at the moving average computation, we will find that all we are doing at each step is to recompute the average by adding the next observation and dropping the observation that occurred  $M$  periods in the past (i.e., the 1st observation in calculating previous  $S$ ).

Odd number of time periods (i.e., 3 yearly, 5 yearly etc.) are usually preferred for determining moving average because the averaged out value ( $S_t$ ) can be placed at the middle of the interval (as shown in Illustration above). If the number of time periods is even, the middle of the interval does not lie against any time point-rather it would lie between two time points. For example, if 4-yearly moving average is attempted in the above case, then the middle of the first interval would lie between 1978 and 1979. In order that comparison of moving averages with the actual value is possible, we prefer odd number of time periods. However, if we need to handle even number of time periods when computing



moving average, we need to add another column to the Table. For example, if in the earlier illustration we take a 4-yearly moving average then the values of moving average would be respectively 51, 64.5, 75, and so on. And, these moving average values will lie respectively between 1978 and 1979, between 1979 and 1980, between 1980 and 1981, and so forth. We will, therefore have to construct a fresh column of centered moving averages where we find the mean of these moving averages-and then place them against the relevant year. For example, is now placed against 1979, = is placed against 1980; and so on. In this manner we overcome the disadvantage of even number of time periods.

➤ **Causal Methods:** More analytical than the preceding methods, causal methods seek to develop forecasts on the basis of specified in an explicit, quantitative manner. The important methods under this category are as follows:

- **Chain ratio method:** A simple analytical approach, this method calls for applying a series of factors for developing a demand forecast.
- **Consumption level method:** Useful for a product that is directly consumed; this method estimates consumption level on the basis of elasticity coefficients, the important ones being the income elasticity of demand and the price elasticity of demand.
- **End use method:** Suitable for intermediate products, the end use method develops demand forecasts on the basis of the consumption coefficient of the product for various uses.
- **Leading indicator method:** According to this method, observed changes in leading indicators are used to predict the changes in lagging variables.

#### 9.2.5.1 Demand Analysis and Managerial Decisions

The quantity demanded at a point of time is subject to many influences. Economists treat price of the product as the single most important variable influencing demand. However, in the highly competitive modern business world, perhaps the other determinants have acquired equal importance, if not more. To keep up-to-date knowledge about the movement of prices of rival firms, changes in tastes and fashion, etc. is essential for survival and growth of a firm.

Management of a firm may also like to find out which of the variables in the demand function can be subject to managerial control. It is quite obvious that factors like population, distribution of consumer





(economically, socially, ethnically and demographically), prices of related goods as well as consumers' present income and their expected future incomes are beyond the control of management of any firm. So, these factors have to be taken as given by the management at any point of time. On the other hand, one finds that management has considerable control over the price of its own product as well as the level and nature of advertisement for its product. With the help of the latter it may influence the tastes and preferences of consumers, thereby generating more demand for its own product.

In short, we may say that the scope of management to influence demand is quite restricted.

### 9.2.6 Market Planning

To enable the product to reach a desired level of market penetration, a suitable marketing plan should be developed. Broadly, it should cover pricing, distribution, promotion, and service. The details that need to be hammered out are shown below:

<b>Pricing</b>	<b>Distribution</b>
Ex-factory price	Packaging
Taxes and duties applicable for the domestic price	Transportation arrangements
Trade margins/discounts	Channel of distribution
Final price to the domestic customer	Wholesalers and retailers.
Export price	-
<b>Promotion</b>	<b>Service</b>
Branding Advertising	Installation
Advertising	User education
Personal selling	Warranties
Promotional efforts	After-sales service

### 9.3 Market Potential Measurement



A market potential is an estimate of the maximum possible sales opportunities present in a particular market segment and open to all sellers of a good or service during a stated future period. Thus, an estimate of the maximum number of low-priced pocket cameras that might be sold in Haryana, during the calendar year 2001 by all sellers is the market potential for low-priced “pocket cameras. A market potential indicates how much of a particular product can be sold to a particular market segment over some future period, assuming the application of appropriate marketing methods. The following steps are to be undertaken for measuring -the market potential of a particular product:

- **Market Identification:** The first step in measuring a product’s market potential is to identify its market. Market identification requires finding answers to three questions:
- Who buys the product?
  - Who uses it?
  - Who are the prospective buyers and/or users?

In some companies answers to these questions are found in internal records; but in most companies, especially those that use long marketing channels, meaningful answers are obtained only through field research. In consumer goods marketing, buyers, users, and prospects are identified and classified by according to such characteristics as age, sex, education, income, and social class. In industrial-goods marketing, buyers, users, and prospects are identified and classified by such characteristics as size of firm, geographical location, and type of industry.

Market identification studies reveal the characteristics that differentiate the market segments making up the product’s total market potential. Frequently they uncover unexploited market segments whose patronage’ might be obtained through redirecting personal-selling effort or changing promotional strategy. Sometimes, market identification studies provide, as a side result, customer data on such factors as purchase frequency, searching time expended, unit of purchase, and seasonal buying habits. When these data are assembled and analyzed, they are helpful in estimating market potential.

- **Market Motivation-**The second step in measuring a product’s market potential is to detect the reasons why customers buy it and the reasons why potential customers might buy it. Market motivation studies aim to answer twin questions: Why do people buy? Why don’t people buy? The



answers are helpful not only in estimating a product's market potential but are of immense value to the sales executive seeking to increase the effectiveness of promotional programs.

Motivation research techniques vary, but the most widely used are the projective techniques, in which respondents project themselves, their attitudes, interests, and opinions into interpretations of special materials presented by the researcher. Analysis of results by trained specialists seeks to lay bare what goes on in buyers' minds, including the real reasons for buying 'or not buying the product. Most motivation studies have been directed toward explaining the buying behavior of ultimate consumers rather than that of industrial users. Information derived from motivation studies helps not only in estimating a product's market potential but assists in deciding:

- How best to present the product in sales talks?
- The relative effectiveness of different selling appeals.
- The relative appropriateness of various promotional methods.

➤ **Measuring of Market Potential**-Having identified the potential buyers and their buying behavior, the third step is to measure the market potential. Generally, market potential cannot be measured directly, so analysis requires the use of market factors (a market factor is a market feature or characteristic related to the product's demand). For instance, the number of males reaching shaving age each year is one market factor influencing the demand for men's electric shavers. But not every male reaching shaving age is a prospective buyer of an electric shaver some will be late in starting to shave, others will adopt other shaving methods, some will not have the money to buy a shaver or will prefer to use that money for something else, and still others will use borrowed shavers or, perhaps, simply will grow beards. Thus, using market factors in measuring market potential is a two-step process:

- Select the market factors most associated with the product's demand.
- Eliminate those market segments that for one reason or another do not contain prospective buyers of the product.

## 9.4 Check Your Progress

1. Which one of the following is a step in the process of market analysis and demand forecasting?
  - (a) Situational analysis and specification of objectives



- (b) Collection of secondary information
  - (c) Conduct of market survey
  - (d) All of the above
2. Which one is the source of secondary information?
- (a) Census of India
  - (b) Economic Survey
  - (c) Annual Bulletin of statistics of Exports and Imports
  - (d) All of the above
3. Which one of the following is a method of demand forecasting?
- (a) Jury of executive opinion method
  - (b) Delphi method
  - (c) Trend projection method
  - (d) All of the above
4. Market potential measurement can be done with the help of following steps?
- (a) Market Identification
  - (b) Market Motivation
  - (c) Measuring of Market Potential
  - (d) All of the above
5. A market survey may relate to one or more of the following:
- (a) Total demand and rate of growth of demand
  - (b) Demand in different segments of the market
  - (c) Income and price elasticity of demand
  - (d) All of the above



6. Which of the following steps includes in a sample survey?

- (a) Define the Target Population
- (b) Select the Sampling Scheme and Sample Size
- (c) Develop the Questionnaire
- (d) All of the above

## 9.5 Summary

Demand analysis covers the likely aggregate demand for the product/service and market share of the proposed project. Situational analysis generates enough data to measure the market. To get a reliable handle over projected demand and revenues, a formal study need not be carried out, particularly when cost and time considerations so suggest. To carry out such a study, it is necessary to spell out its objectives clearly and comprehensively. Secondary information is information that has been gathered in some other context and is already available. It provides the base and the starting point for demand analysis. It indicates what is known and often provides leads and cues for gathering primary information required for further analysis. Secondary information, though useful, often does not provide a comprehensive basis for demand analysis. It needs to be supplemented with primary information gathered through a market survey, specific to the project being appraised. The market survey may be a census survey or a sample survey. In a census survey the entire population is covered.

Based on the information gathered from secondary sources and through the market survey, the demand for the product/service may be described after consideration of many factors. An efficient demand forecast helps the management to take suitable decisions regarding plant capacity, raw-material requirements, space and building needs and availability of labor and capital. Production schedules can be prepared in conformity with demand requirements minimizing inventory, production and other related costs. To enable the product to reach a desired level of market penetration, a suitable marketing plan should be developed. Broadly, it should cover pricing, distribution, promotion, and service.

A market potential indicates how much of a particular product can be sold to a particular market segment over some future period, assuming the application of appropriate marketing methods. Market



identification, market motivation and measuring of market potential are the steps in market potential measurement.

## 9.6 Keywords

- **Demand Analysis:** It is a process of understanding the customer demand for a specific product or services in a particular market area.
- **Distribution channels:** Chains that provide product to customer from manufacturer included agents, retailer and wholesalers also.
- **Potential customers:** Customers that are buying products of our competitors or other manufacturer, and can buy our product in future.
- **Secondary information:** It is information that has been gathered in some other context and is already available.
- **Primary information:** It information that is collected for the first time to meet the specific purpose on hand.
- **Census of India:** Publication of the Government of India, it provides information on population, demographic characteristics, household size and composition.
- **Questionnaire:** A document that contains a list of questions.
- **Sales Promotion:** Selling of goods & services with the help of discount, gift, free items, cash refund offer, samples etc.
- **Government Policy:** Rules and regulation of government regarding production of goods in a specific country.
- **Delphi method:** This method involves converting the views of a group, of experts, who do not interact face-to-face, into a forecast through an interactive process.
- **Market potential:** It is an estimate of the maximum possible sales opportunities present in a particular market segment and open to all sellers of a good or service during a stated future period.



- **Sampling Scheme:** It is detailed description of what data will be obtained and how this will be done. Simple random sampling, cluster sampling etc.
- **Sample Size:** It is the act of choosing the number of observation for a particular statistical sample.

### 9.7 Self-Assessment Test

- Describe briefly the general sources of secondary information available in India.
- Discuss the key steps in a sample survey.
- Define the term 'Market Potential'. How it can be measured?
- Briefly discuss the key steps involved in demand analysis.

### 9.8 Answers to check your progress

- 1(d), 2 (d), 3(d), 4 (d), 5(d), 6 (d)

### 9.9 References/ Suggested Readings

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<b>WORKING CAPITAL MANAGEMENT</b>	

## Structure

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### 10.0 Learning Objectives

After reading this lesson, you will be able to:





- Define working capital and explain the determinants of working capital.
- Discuss the various dimensions of working capital.
- Enlist the various sources of working capital finance.
- Make an evaluation of Tandon Committee.

## 10.1 Introduction

Working capital is the lifeblood of a business. It's adequate planning and proper management is necessary for the successful operation and continued existence of a business. Efficient management of working capital is a basic necessity for sound operational health of a every enterprise. Therefore, working capital management is an integral part of business management. Working capital management basically means management of current assets, current liabilities, and interrelationship between the two. Working capital is of a liquid nature. Therefore, working capital management is also called 'liquidity management'.

## 10.2 Concept of Working Capital

Working capital is understood in the following two ways:

**Net Working Capital:** Net working capital is the excess of current assets over the current liabilities. In other words, it may be defined as the provision of long term (non-current) funds for current assets. The use of the concept of net working capital is qualitative as provides a measurement of the financial health of a firm. The higher the amount of net working capital in relation to sales, the better the current financial-health of the firm. The net working capital also indicates the 'margin of safety' for meeting the maturing short-term liabilities (claims).

**Gross Working Capital:** Gross working capital is considered to be equal to the total current assets required by a business firm. In this context, the concept of total current assets has a broader application. It is intended to denote the total investment of funds in current assets for operation purposes or the total requirement of funds for current assets regardless of the financing sources.

### Components of Gross Working Capital

The constituent parts of gross working capital, otherwise called current assets, are:



- Advance given for purchases of raw materials and stores, etc.
- Inventories:
  - Raw materials, stores and packing material, spare parts, etc.
  - Work-in-process.
  - Finished goods.
- Book debtors or credit to customers.
- Marketable investment (securities) on short-term basis:
  - To earn something on temporary surplus cash.
  - To meet the requirement of offering security for some facilities and/ or contract with government or some other agencies.
- Cash and bank balances.

### Nature of Current Assets and the Cash Operating Cycle

All current assets (except cash) finally get converted into cash. In fact, each current asset is heading towards conversion into cash. In a typical business, cash is invested in materials, supplies, labour and various overhead services, and these costs are traced through and attached to inventories.

Inventories are eventually realized by conversion into book debts (Accounts receivable) and these are in turn collected and become once more the available purchasing power. The average laps of time between the investment in materials and services and the final conversion back to cash is the length of the cash operating cycle. Such an operating cycle maybe computed as follows:

#### Computation of Cash Operating Cycle

<i>Operating cycle Flow</i>	<i>Computation Method</i>
Cash (and credit)	
	365
Materials, labour, services	-----



## Raw materials turnover- Average credit period

	365
Production	-----
	Production in process turnover
	365
Storage sales	-----
	Finished product turnover
	365
Accounts receivable	-----
	Accounts receivable turnover
Cash (and credit)	
	Total

**Note:** The above format is for a manufacturing company and is based on the assumption that the accounting figures available are for a one-year operation. In a trading organization, the production phases are substituted by the merchandise acquisition phase.

### 10.2.1 Determinants of Working Capital

There are no set rules or formulae to determine the working capital requirements of the firms. A large number of factors influence the working capital needs of the firms. All factors are of different



importance. Also, the importance of the factors changes for a firm over time. Therefore, an analysis of the relevant factors should be made in order to determine the total Investment in working capital. The following is the description of the factors which generally influence the working capital requirements of the firms.

- **Nature and Size of Business**-The working capital requirements of a firm are basically influenced by the nature of its business. Trading and financial firms have very less investment in fixed assets, but require a large sum of money to be invested in working capital. Retail stores, for example, must carry large stocks of a variety of goods to satisfy the varied and continuous demand of their customers. Some manufacturing businesses, such as tobacco manufactures and construction firms, also have to invest substantially in working capital and a nominal amount in the fixed assets. In contrast, public utilities have a very limited need for working capital and have to invest abundantly in fixed assets. Their working capital requirements are nominal because they have cash sales only and supply services, not product. Thus, no funds will be tied up in debtors and stock (inventories). The working capital needs of most of the manufacturing concerns fall between the two extreme requirements of trading firms and public utilities. Such concerns have to make adequate investment in current assets depending upon the total assets structure and other variables.
- **Manufacturing Cycle**-The manufacturing cycle starts with the purchase and use of raw materials and completes with the production of finished goods. Longer the manufacturing cycle, larger will be the firm's working capital retirements. An extended manufacturing time span means a larger tie-up of funds in inventories. Thus, if there are alternative ways of manufacturing a product, the process with the shortest manufacturing cycle should be chosen. Once a Manufacturing process has been selected, it should be ensured that manufacturing cycle is completed within the specified period. This needs proper planning and coordination at all levels of activity. Any delay in manufacturing process will result in accumulation of work in process and waste of time. In order to minimize their investment in working capital, some firms, specifically the firms manufacturing industrial products, have a policy of asking for advance payments from their customers.
- **Business Fluctuation**-Most firms experience seasonal and cyclical fluctuations in the demand for their products and services. These business variations affect the working capital requirements, specially the temporary working capital requirements of the firm. When there is an upward swing in



the economy, sales will increase; correspondingly, the firm's investment in inventories and book debts will also increase. Under boom, additional investment in fixed assets may be made by some firms to increase their production capacity. This act of the firms will require further addition to working capital. To meet their requirements of funds for fixed assets and current assets under boom period, the firms generally resort to substantial borrowings.

On the other hand, when there is a decline in the economy, sales will fall and consequently, the levels of inventories and book debts will also fall. Under recessionary conditions, the firms try to reduce their short-term borrowings.

Seasonal fluctuations not only affect the working capital requirement but also create production problems for the firm. During the periods of peak demand, increasing production may be expensive for the firm. Similarly, it will be more expensive during slack periods when the firm has to sustain its work force and physical facilities without adequate production and sales. A firm may, thus, follow a policy of steady production, irrespective of the seasonal changes, in order to utilize its resources to the fullest extent. Such a policy will mean accumulation of inventories during the off season and their quick disposal during the peak season. The increasing levels of inventories during their slack season will require increasing funds to be tied up in the working capital for some months.

- **Production Policy-** We just noted that a strategy of constant production may be maintained in order to resolve the working capital problems arising due to seasonal changes in the demand for the firms' product. A steady production policy will cause inventories to accumulate during the off-season and the firm will be exposed to greater inventory costs and risks. Thus, if the costs and risks of maintaining a constant production schedule are high, the firm may adopt the policy of varying its production schedules in accordance with the changing demand. The firms, whose production capacities can be utilized for manufacturing varied products, can have the advantage of diversified activities and solve their working capital problems. They will manufacture the original product line during its increasing demand and when it has an off-season; other products may be manufactured to utilize the physical resources and working force. Thus, the production policies will differ from firm to firm, depending on the circumstances of individual firm.



- **Firm's Credit Policy**-The credit policy of the firm affects working capital by influencing the level of book debts. The credit terms to be granted to the customers may depend upon the norms of the industry to which the firm belongs. But a firm has the flexibility of shaping its credit policy within the constraint of industry norms and practices. The firm should be discrete in granting credit terms to its customers. Depending upon the individual case, different terms may be given to different customers. A liberal credit policy, without rating the credit-worthiness of the customers, will be detrimental to the firm and will create a problem of collecting funds later on. The firm should be prompt in making collections. A high collection period will mean tie-up of funds in book debts. Slack collection procedures can increase the chance of bad debts.
- **Availability of Credit**-The working capital requirements of a firm are also affected by credit terms granted by its creditors. A firm will need less working capital if liberal credit terms are available to it. Similarly, the availability of credit from banks also influences the working capital needs of the firm. A firm, which can get bank credit easily on favorable conditions, will operate with less working capital than a firm without such a facility.
- **Growth and Expansion Activities**-The working capital needs increase as a firm grows in terms of sales or fixed assets. It is difficult to precisely determine the relationship between volume of sales and the working capital needs. The critical fact, however, is that the need for increasing working capital funds does not follow growth in business activities but precedes it. It is, therefore, necessary to make advance planning of working capital for a growing firm on a continuous basis.

A growing firm may need to invest funds in fixed assets in order to 'sustain its growing production and sales. This will, in turn, increase investment in current assets to support enlarged scale of operations. It should be realized that a growing firm needs funds continuously. It uses external sources as well as internal sources to meet the increasing needs of funds. Such a firm faces further financial problems when it retains substantial portion of its profits. It would be unable to pay dividends to shareholders. It is, therefore, imperative that proper planning may be done by such companies to finance their increasing needs for working capital.
- **Profit- Margin and Profit Appropriation**-Firms differ in their capacity to generate profit from business operations. Some firms enjoy a dominant position, due to quality product or good



marketing management or monopoly power in the market and earn a high profit margin. Some firms may have to operate in the environment of intense competition and may earn low margin of profits. A high net profit margin contributes towards the working capital pool. In fact, the net profit is a source of working capital to the extent it has been earned in cash. The cash profit can be found by adjusting non-cash items, such as depreciation, outstanding expenses, accumulated expenses and losses written off, in the net profit. But, in practice, the net cash inflows from operations cannot be considered as cash available for use at the end of the period. Even as the company's operations are in progress, cash is used for augmenting stocks, book debts or fixed assets. The financial manager must see whether or not the cash generated has been used for rightful purposes. The application of cash should be well planned.

- **Price Level Changes**-The increasing shifts in price levels make the functions of financial manager difficult. He should anticipate the effect of price level changes on working capital requirements of the firm. Generally, rising price levels will require a firm to maintain higher amount of working capital. The same levels of current assets will need increased investment when prices are increasing. However, the companies which can immediately revise their product prices with rising price levels will not face a severe working capital problem. Further, the effects of increasing general price level will be felt differently by the firms as individual price may move differently. It is possible that some companies may not be affected by the rising prices while others may be badly hit by it. Thus, the effects of rising prices will be different for different companies. Some will face no working capital problems, while the working capital problems of others may be aggravated.
- **Operating Efficiency**-The operating efficiency of the firm relates to the optimum utilization of resources at minimum costs. The firm will be effectively contributing to its working capital if it is efficient in controlling the operating costs. The use of working capital is improved and pace of the cash cycle is accelerated with operating efficiency. Better utilization of resources improves profitability and, thus, helps in releasing the pressure on working capital. Although it may not be possible for a firm to control the prices of materials or the wages of labour, but it can certainly ensure efficient and effective use of its materials, labour and other resources.

### 10.2.2 Dimensions of Working Capital Management



We have emphasized that the firm should maintain a sound working capital position, and that there should be optimum investment in working capital. Thus, there is an unavoidable need to manage working capital well. Working capital management refers to the administration of all aspects of current assets, namely cash, marketable securities, debtors and stock (inventories) and current liabilities. The financial manager must determine the levels and composition of current assets. He must see that right sources are tapped to finance current assets and current liabilities are paid in time.

There are many aspects of working capital management which make it an important function of the financial manager.

- Working capital management requires much of the financial manager's time.
- Working capital represents a large portion of the total investment in assets.
- Working capital management has greater significance for small firms.
- The need for working capital is directly related to sales growth.

Empirical observations show that the financial managers have to spend much of their time to the daily internal operations, relating to current assets and current liabilities of the firms. As the largest portion of the financial manager's valuable time is devoted to working capital problems, it is necessary to manage working capital in the best possible way to get maximum benefit.

Investment in current assets represents a very significant portion of the total investment in assets. For example, according to an estimate of Reserve Bank of India, in case of the 1650 large and medium public limited companies in India, current assets constituted 62 per cent of total net assets or total capital employed in 1975-76. This very clearly indicates that the financial manager should pay special attention on the management of current assets on a continuing basis. Actions should be taken to curtail unnecessary investment in current assets.

It is particularly very important for small firms to manage their current assets and current liabilities very carefully. A small firm may not have much investment in fixed assets, but it has to invest in current assets, such as cash, debtors and inventories. Further, the role of current liabilities in financing current assets is far more significant in case of small firms as unlike large firms; they face difficulties in raising long-term finance.





There is a direct relationship between sales and working capital needs. As sales grow, the firm needs to invest more in inventories and book debts. These needs become very frequent and fast when sales grow continuously. The financial manager should be aware of such needs and finance them quickly. Continuous growth in sales may also require additional investment in fixed assets, but they do not indicate same urgency as displayed by current assets.

It may, thus, be concluded that all precautions should be taken for the effective and efficient management of working capital. The financial manager should pay particular attention to the levels of current assets and the financing of current assets. To decide the levels and financing of current assets, the risk return implications must be evaluated.

#### ➤ **Estimating Working Capital Requirements**

As stated earlier both excess and shortage of working capital are harmful for the health of an enterprise. It is, therefore, essential to correctly assess the amount of working capital for an enterprise.

The following methods can be used to estimate the amount of working capital:

- ❖ **Operating Cycle Method:** If for instance, the operating cycle of an enterprise is four months, it means the cycle is repeated three times in a year. The amount of working capital required would be one-third ( $1/3$ ) of the amount of annual operating expenses.

Thus,

$$\text{Amount of working capital} = \frac{\text{Total operating expenses in the year}}{\text{Number of operating cycles in the year.}}$$

The figure so arrived at should be adjusted in accordance with changes in the price level.

- ❖ **Assets and Liabilities Method:** The amount of working capital can also be estimated on the basis of current assets required for the business and the credit facilities (current liabilities) available for the acquisition of current assets.

**Illustration 10.1:** From the following information estimate the amount of working capital required.



Budgeted Sales (Rs. 10 per unit)	Rs. 2,60,000
Cost of sales (per rupee)	
Raw materials	0.30
Direct labour	0.40
Overheads	0.20
Total cost	0.90
Profit	0.10
Sales	1.00

It is estimated that:

- Raw materials are carried in stock for three weeks and finished goods for two weeks
- Factory processing will take three weeks
- Suppliers will give full five weeks credit
- Customers will require eight weeks credit

It may be assumed that production and overheads accrue evenly throughout the year.

### Statement of Working Capital

Current Assets (1)	Rs.	Rs.
Stock		
Raw materials (3weeks)		= 4500
Work in progress (Note iv)		= 9000
Finished goods (2 weeks)		= <u>9000</u>
		22,500
Debtors (8weeks)		= <u>40000</u>
		62,500

**Current Liabilities (2)**

Trade creditors (5weeks) = 7500

Working capital required (1-2)

**Working Notes**

(i)	Budgeted sales	2,60,000	
	Selling price per unit	10	
	Number of units	260000/10	= 26,000
(ii)	Cost of sales	Rs.	
	Raw materials	26000 x 3	= 78,000
	Direct labour	26000 x 4	= 1,04,000
	Overheads	26000x2	= <u>52,000</u>
			<u>2,34,000</u>
(iii)	Number of weeks per annum have been taken as 52		
(iv)	Work in progress:	Rs.	
	Raw materials 3/52 x 78,000	=	4,500
	Wages 3/52 x 104000 x ½	=	3,000
	Over-heads 3/52 x 52000 x ½	=	<u>1,500</u>
			<u>9,000</u>

Since, wages and overheads accrue evenly during the year, they have been reduced to one-half.

**Illustration 10.2:** A proforma cost sheet of a company provides the following particulars:

	Amount per unit (Rs.)
<b>Elements of cost</b>	
Raw materials	80
Direct labour	30
Overhead	<u>60</u>
Total cost	170
Profit	<u>30</u>
Selling price	<u>200</u>

The following further particulars are available:



Raw materials in stock, on average on month; Materials are in process, on average half a month; Finished goods in stock, on average on month.

Credit allowed by suppliers is one month; Credit allowed to debtors is two months; Average time-lag in payment of wages is 1½ weeks and one month in overhead expenses; one-fourth of the output is sold against cash; cash in hand and at bank is expected to be Rs. 3, 65,000. You are required to prepare a statement showing the working capital needed to finance a level of activity of 1, 04,000 units of production.

You may assume that production is carried on evenly throughout the year, and wages and overheads accrue similarly.

### Solution:

Working notes and assumptions:

- (i) 26,000 units have been sold for cash. Therefore, credit sales pertain to 78,000 units only.
- (ii) Year has 52 weeks.
- (iii)
  - (a) Profits may be or may not be a source of working capital.
  - (b) Profits are to be adjusted for income-tax and dividend payments. For these reasons, profits have been ignored.
- (iv) All overheads are assumed to be variable. Presence of depreciation element in overheads will lower the working capital requirement.
- (v) Work-in-process at 50% completion stage.

**Table No.1: Statement showing determination of net working capital**

	Amount (Rs.)
(a) Current assets:	
(i) Stock of materials for 1 month:	
$\frac{1,04,000 \times \text{Rs.} 80 \times 4}{52}$	6,40,000
(ii) Work-in-Progress for ½ month:	



(a)	Material	$(1,04,000 \times 80 \times 2) / 2 \times 50 \%$	1,60,000
(b)	Labour	$(1,04,000 \times 30 \times 2 / 52) \times 50\%$	60,000
(c)	Overheads	$(1,04,000 \times 60 \times 2 / 52) \times 50\%$	1,20,000
(iii)	Finished goods for 1 month:		
(a)	Material	$(1,04,000 \times 80 \times 4 / 52)$	6,40,000
(b)	Labour	$(1,04,000 \times 30 \times 4 / 52)$	2,40,000
(c)	Overheads	$(1,04,000 \times 60 \times 4 / 52)$	4,80,000
(iv)	Debtors for 2 months	$(78,000 \times 170 \times 8 / 52)$	20,40,000
(v)	Cash in hand and at bank		3,65,000
	Total investment in current assets		47,45,000
(B)	Current Liabilities:		
	(i) Creditors		
	1 month's purchase of raw materials, i.e.		6,40,000
(ii)	Average time-lag in-payment of expenses		
	(a) Overheads (1 month)	$(1,04,000 \times 60 \times 4 / 52)$	4,80,000
	(b) Labour (1½ weeks)	$(1,04,000 \times 30 \times 3 / 104)$	90,000
	Total estimate of current liabilities		<u>12,10,000</u>
(C)	Net working capital:		
	= Current assets – Current liabilities (A–B)		35,35,000

Reserve Bank of India has prescribed the following proforma for use by commercial banks to assess the working capital requirements of borrowers.



### Assessment of Working Capital Requirement

Month's raw material requirements weeks'/months' consumable stores and spares	Rs.
Weeks' stock-in-progress at any one time (average period of processing, value of raw material content in stock-in-process and manufacturing expenses for the period of processing to be indicated)	Rs.
Months' finished goods at cost	Rs.
Weeks'/months' receivables representing credit sales	Rs.
One month's manufacturing and administrative expenses	Rs.
Total working capital requirements	Rs.
Less: Credit available on purchase and advance payments received	Rs.
Working capital in business or liquid surplus	Rs.
Net working capital requirements	Rs. (A)

### Permissible Limits

Raw materials	Rs.	Rs.
Less: Margin	<u>Rs.</u>	Rs.
Stock-in-process	Rs.	
Less: Margin	<u>Rs.</u>	Rs.
Finished goods	Rs.	
Less: Margin	<u>Rs.</u>	Rs.
Receivables		
Representing supplies to Govt.	Rs.	
Less: Margin	<u>Rs.</u>	Rs.



Representing supplies to sundry parties	Rs.	
Less: Margin	<u>Rs.</u>	<u>Rs.</u>
Total Limit	<u>Rs.</u>	<u>Rs.</u>
Net working capital requirements		Rs. (B)
Permissible limits		<u>Rs. (A)</u>
Deficit (if any) (A–B)		Rs.
How this is to be met?		Rs.

### 10.3 Sources of Finance and Forms of Credit

After determining the level of working capital, as illustrated earlier, a firm has to decide how it is to be financed. The present part discusses the related aspect of the sources of finance for working capital and forms of credit. The sources of finance for working capital may be said to fall into four categories, namely,

- Trade Credit;
- Bank Credit;
- Current provisions of non-bank short-term borrowings; and
- Long-term sources comprising equity capital and long-term borrowings.

The relative importance of these varies from country to country and from time to time depending on the prevailing environment. In India, the primary sources for financing working capital are trade credit and short-term bank credit. According to an estimate, both these sources together finance about three- fourth of the working capital requirement of industry. Another estimate regarding the relative contribution of various sources reveals that trade credit constitutes the most important source accounting for approximately two-fifths of the total while short-term bank credit finances more than one- fourth.

Thus, bank credit is the primary institutional source for working capital finance. To obtain short-term bank credit, working capital requirements have to be estimated by the borrowers and the banks are



approached with the necessary supporting data. The banks determine the maximum credit based on the margin requirements of the security. The margin represents a percentage of the value of the asset offered as security by the borrower. For example, if the margin requiring on a particular item is 50%, the bank will be prepared to provide credit up to Rs. 50,000 against the security of an asset worth Rs. 1,00,000. The margin is based on the nature of goods and is laid down by the Reserve Bank of India. It is changed from time to time to suit the requirement of credit policy.

### ➤ Forms of Credit

After getting the over-all credit limit sanctioned by the banker, the borrower draws funds periodically. The following forms of credit are available to him:

- **Loan Arrangement:** Under this arrangement the entire amount of loan is credited by the bank at the borrower's account. In case the loan is repaid in installments, interest is payable on actual balances outstanding.
- **Overdraft Arrangements:** Under this arrangement, certain facilities are available to the borrowers which are not available under the loan arrangement. With the overdraft arrangement the borrower is allowed to overdraw on his current account with the bank up to a stipulated limit. Within this limit any number of drawings is permitted. Repayments can be made whenever desired during the period. The interest liability of the borrower is determined on the basis of the actual amount utilized.
- **Cash Credit Arrangement:** This form of credit is operated in the same way as the overdraft arrangement. The borrower can draw upto a stipulated limit based on the security margin. He has to pay 1% as commitment charges on the unutilized balance during the period. Cash credit is usually allowed against pledge or hypothecation of goods and the borrower can provide alternative securities from time to time in conformity with the terms of advance.
- **Bills Purchased and Bills Discounted:** This arrangement is of relatively recent origin in India. With the introduction of the New Bill Market Scheme in 1970 by the Reserve Bank of India, bank credit is being made available through discounting of usance bills by banks. In brief, under the scheme, the Reserve Bank of India envisages the progressive use of bills as an instrument of credit as against the current practice of using the widely-prevalent cash credit arrangement for financing working capital. This is because the cash credit arrangement gave rise to unhealthy practices. In the





first place, as the availability of bank credit was unrelated to production needs, borrowers in the organised sector of private industry enjoyed facilities in excess of their legitimate needs. Moreover, it led to double financing. This was possible because credit was taken from different agencies for financing the same activity. This was done, for example, by buying goods on credit from suppliers and raising cash credit by hypothecating the same goods. The Bill Market Scheme is intended to link credit with the sale and purchase of goods and, thus, eliminate the scope for misuse or diversion of credit to other purposes.

The amount made available under this arrangement is covered by the cash credit and overdraft limit before discounting the bill the bank satisfies itself about the credit worthiness of the, drawer and the genuineness of the bill. To popularize the scheme, the discount rates are fixed at lower rates than those of cash credit, the difference being about 1-1.5%. The discounting banker asks the drawer of the bill (i.e. seller of goods) to have his bill accepted by the drawees (buyers) bank before discounting it. The latter grants acceptance against the cash credit limit, earlier fixed by it on the basis of the borrowing value of stocks. Therefore, the buyer who buys goods on credit cannot use the same goods as a source of obtaining additional bank credit.

- **Term Loans for Working Capital:** Under this arrangement banks advance loans for 3-7 years repayable in yearly or half-yearly installments.
- **Mode of Security:** Banks provide credit on the basis of the following modes of security:
  - **Hypothecation-**Under this mode of security, the banks provide credit to borrowers against the security of movable property, usually inventory of goods. The goods hypothecated, however continue to be in the possession of the owner of these goods (i.e., the borrower). The rights of the lending bank (hypothecated) depend upon the terms of the contract between the borrower and the lender. Although the bank does not have physical possession of the goods, it has the legal right to sell the goods to realize the outstanding loan.
  - **Pledge-**Pledge, as a mode of security, is different from hypothecation in that in the former, unlike in the latter, the goods which are offered as security are transferred to the physical possession of the lender. An essential prerequisite of pledge, therefore, is that the goods are in the custody of the bank. The borrower, who offers the security is, called a “pawner” while the



banks called the “pawner”. The lodging of the goods by the pawnor to the pawnee is a kind of bailment. Therefore, pledge creates some liabilities for the bank. It must take reasonable care of goods pledged with it. The term “reasonable care” means care which a prudent person would take to protect his property. He would be responsible for any loss or damage if he use the pledged goods for his own purposes. In case of non-payment of the loans, the bank enjoys the right to sell the goods.

- **Lien**-The term “lien” refers to the right of a party to retain goods belonging to another party until a debt due to him is paid. Lien can be of two types: (i) particular lien, and (ii) general lien. Particular lien is a right to retain goods until a claim pertaining to these goods is fully paid. On the other hand, general lien can be applied till all dues of the claimant are paid. Banks enjoy general lien.
- **Mortgage**-It is the transfer of interest in specific immovable property for securing the payment of money advanced. The person who parts with the interest in the property is called “mortgagor” and the person in whose favour the transfer takes place is the mortgagee. Mortgage is, thus, conveyance of interest in the mortgage property. The mortgage interest in the property is terminated as soon as the debt is paid.
- **Charge**-Where immovable property of one person is by the act of parties or by the operation of law made security for the payment of money to another and the transaction does not amount to mortgage, the latter person is said to have a charge on the property and all the provisions of simple mortgage will apply to such a charge. These are:
  - A charge is not the transfer of interest in the property though it is security for payment. But a mortgage is a transfer of interest in the property.
  - A charge may be created by the act of parties or by the operation of law. But a mortgage can be created only by the act of parties.
  - A charge needs to be made in writing but a mortgage deed must be attested.



- Generally, a charge cannot be enforced against a transferee for consideration without notice. In a mortgage the transferee of the mortgaged property can acquire the remaining Interest in the property, if any.
- **Accrual Accounts:** There is a time lag between receipts of income and making payment for the expenditure incurred in earning that income. During this time lag, the outstanding expenses help an enterprise in meeting some of its working capital needs. For example, wages and taxes become due but are not paid immediately. Wages and salaries are paid in the first week of the month next to the month in which services were rendered. Similarly, a provision for tax is created at the end of the financial year but tax is paid only after the assessment is finalized.
- **Merits**
  - Accrual accounts are a spontaneous source of finance as these are self-generating.
  - Financing through accruals is an interest free method and no charge is created on the assets.
  - As the size of business increases, the amount of accruals also increases.
- **Demerits**
  - An enterprise cannot indefinitely postpone the payment of wages/salaries and taxes. Therefore, it is not a discretionary source of finance.
  - This source should be used only as a matter of last resort.
- **Factoring-**Factoring is an arrangement under which a financial institution (called factor) undertakes the task of collecting the book debts of its client in return for a service charge in the form of discount or rebate. The factoring institution eliminates the client's risk of bad debts by taking over the responsibility of book debts due to the client. The factoring institution advances a proportion of the value of book debts of the client immediately and the balance on maturity of book debts.
- **Merits**



- As a result of factoring services, the enterprise can concentrate on manufacturing and selling.
- The risk of bad debts is eliminated.
- The factoring institution also provides advice on business trends and other related matters.
- **Demerits**
  - A substantial amount of discount or rebate has to be paid to the factoring concern.
  - If the factoring institution uses strong arm tactics to collect money it will spoil the image and relations of the firm with its customers.
- **Advances from Customers**-Manufacturers and suppliers of goods which are in short supply usually demand advance money from their customers at the time of accepting their orders. For example, a customer has to make an advance at the time of booking a car, a telephone connection, etc. Similarly, contractors constructing buildings, etc. require an advance from the client. In some businesses it has become customary to receive advance payment from the customers. This is a very cheap source of short term finance because either no interest is payable or the rate of interest payable on advance is nominal.

### 10.3.1 Management of Working Capital

Working capital management refers to all aspects of the administration of both current assets and current liabilities. The basic objective here is to manage the firm's current assets and current liabilities in such a way that a satisfactory level of working capital is maintained i.e. it is neither inadequate nor excessive. If the current assets are not sufficient to cover current liabilities the liquidity of business is affected and there is no safety margin. On the other hand, if the working capital is excessive, firm's profitability is affected. It is also necessary that different components of working capital are properly balanced. For instance firm's liquidity will be low despite sufficient working capital if the amount of obsolete/slow moving inventory is very high.

A brief description of managing different components of working capital is given below.



- **Management of Cash:** It is necessary to maintain adequate cash to pay current liabilities and to meet unexpected contingencies. At the same time, idle cash should be avoided as it means loss of income. Cash management involves (a) controlling the level of cash through cash budgeting, cash flow statement contingency arrangements with banks, etc. (b) controlling cash inflows through decentralised collection of bank debts, etc. (c) controlling cash outflows through centralized disbursements, etc. and (d) investing surplus cash appropriately.
- **Management of Inventory:** Inventories constitute the principal item in the working capital of the majority of trading and industrial companies. In inventory we include raw materials, finished goods, work-in-progress, supplies and other accessories. To maintain the continuity in the operations of business enterprise, a minimum stock of inventory is required. Though the physical control of inventory is the operating responsibility of store superintendent, and financial personnel have nothing to do about it. But the financial control of these inventories in all lines of activity in which they comprise a substantial part of the current assets is a frequent problem in the management of working capital. Management of inventory is designed to regulate the volume of investment in goods in hand and the types of goods carried in stock to meet the needs of production and sales while at the same time, the investment in them is to be kept at a reasonable level.
- **Management of Accounts receivable:** Account receivables constitute a significant portion of current assets. A firm sells goods on credit to increase the volume of sales. But it involves loss of interest and risk of bad debt. The objective of receivables management is to ensure that the cost involved in financing bank debts does not exceed the income from investment in bank debts. The size of accounts receivable depends on the level of credit sales, credit period, terms of credit, cash discount offered, and efficiency of collection. In order to minimize investment in accounts receivable without sacrificing the firm's competitive position, it is necessary to lay down specific credit standards, to adopt a sound credit policy and to adopt efficient collection procedures.
- **Management of Accounts Payable:** Working capital requirement can be reduced by obtaining liberal terms of credit from suppliers. While managing accounts payable the saving of interest cost through delayed payments should be offset against loss of credit standing of the firm. Thus, effective management of working capital involves the following measures.



- Controlling the amount of cash in hand and cash at bank through speedy collection of money from debtors and checking untimely outflows of cash.
- Forecasting cash needs to identify surplus cash that can safely be invested for a temporary period to earn income.
- Budgeting the raw material needs and devising a proper system of inventory control.
- Ensuring uninterrupted operations to minimize blockage of working capital in work in progress.
- Expediting dispatch of finished goods to realize cash fast.
- Ensuring proper balance between different components of working capital.
- Blending judiciously the different sources of working capital so as to minimize the cost of raising such capital.

### 10.3.2 Tandon Committee

The Report of the Study Group to Frame Guidelines for follow-up of Bank Credit, popularly known as Tandon Committee, was an almost revolutionary development in the sphere of distribution of bank credit in accordance with planning priorities.

The peculiarities of the Indian banking system called for a scientific system of rationing of bank credit. The nationalization of the major commercial banks brought about a transformation in the banking system in India. Moreover, public enterprises turned to banks for their working capital needs. Since industries were to be developed in all parts of the country, credit had also to be distributed on an equitable, national basis. In the context of the growing demand from various types of borrowers, bank credit had become an extremely scarce commodity. Another peculiar feature of the Indian banking was the inherent weakness of the prevailing commercial credit system which was popularly known as the cash credit system with its three elements of annual credit limits, drawing accounts and drawing power based on a security-stipulation. This has been the subject of serious criticism and the Deheja Committee questioned the direction and purpose of bank lending. It commented extensively on the shortcomings of the prevalent system of security-cum-guarantee-oriented approach to lending that had led to over-financing of large industry. In the context of the new approach to lending, with the emphasis shifting



from security-oriented to production-related lending, it was necessary to strictly ration bank credit to large industry, thereby meeting genuine needs and preventing a wasteful utilization of credit. It was also necessary that banks should keep in close touch with the operations of the borrowers so as to ensure that borrowed funds are used properly and the desired objectives are achieved. The unprecedented inflation in 1974 and the rise in demand for credit compelled a close look at the existing system to remove all shortcomings. It was against this background that the Tandon Committee was constituted by the Reserve Bank of India. Its main recommendations were as follows:

**Recommendations-**The recommendations of the Group cover practically all aspects of lending. It has suggested an integrated scheme to ensure the planned provision of credit and supervise its use such that bank credit leads to rapid economic development. The salient features of the package system recommended by the Study Group are based on three rules. First, the desirability of developing financial discipline planning and budgeting by the borrowers so as to make banks and their customer's partners in a joint venture, the banks providing the wherewithal for working, and the customers are using it constructively. This, in turn, implies an appraisal system. Borrowers should, therefore, supply information to their bankers relating to the broad features of their operating plans for the ensuing year. This would serve as the basis for a realistic appraisal of their needs and subsequent periodic follow-up during the ensuing year. At present, review-cum-appraisal is not done annually in many cases and in most cases it is based on two year-old information, not on what is intended to be done during the ensuing year; follow-up is confined merely to a check on security; it does not cover the operations of the borrower. The second rule on which the recommendations of the Group are based is the need to relate inventory and bank credit to production. Finally, the banks should know the end-use of bank credit so as to prevent its diversion for purposes other than those for which it is made available. Banks should, therefore, finance only a reasonable part of the working capital gap so as to ensure a minimum current ratio. The salient features of the scheme suggested by the Tandon Committee are now outlined.

**Fixation of Norms-**A notable feature of the recommendations of the Tandon Panel relates to fixation of "norms" for bank lending to industry. The "norms" conceived by the Group fall into two categories: (i) Inventory Norms, and (ii) Lending Norms.

**Inventory Norms-**The term 'norms' refers to the maximum level for holding inventories and receivables in each industry. The Study Group has envisaged that eventually the entire system of credit



planning should be dovetailed with production planning, both to make efficient use of bank credit and also to ensure better management of cash, materials and receivables. As a beginning in that direction, it has suggested inventory and receivable norms. It may, however, be noted that this recommendation of the Tandon Group is not entirely original. Certain banks have been following such norms in assessing credit requirements of borrowers before the Panel came out with its proposals. However, there was not uniform approach and banks permitted deviations on the slightest pretext, presumably from fear of losing customers to competing banks. What the Group has really done in this respect is that it has formalized the approach.

The criteria underlying the emphasis on such norms, according to the Group, were (i) bank credit is to be viewed as a tool for resource allocation in the economy and (ii) banks must uniformly assess working capital requirements. In this context the committee suggested inventory and receivable norms in respect of 15 major industries which accounted for about one-half of the industrial advances of banks.

The norms suggested by the Group pertain to (i) raw materials including stores and other items used in the process of manufacture; (ii) stock-in-process; (iii) finished goods; and (iv) receivables and bills purchased and discounted. The norms have been worked out on the basis of “time element”. Raw materials are expressed as so many month’s consumption; stock-in-process are expressed as so many month’s cost of production; finished goods and receivables are expressed as so many months’ cost of sales respectively. The norms prescribed for receivables relate only to inland sales on a short-term basis, i.e. excluding receivables arising out of deferred payment sales and exports. These norms have been fixed taking into account (1) company finance studies by the Reserve Bank of India, (2) process period in different industries, (3) discussions with experts in the industries concerned, (4) general discussions with industry, (5) need for ensuring smooth production, depending upon the availability of the materials, seasonality, etc., and (6) reaction and feedback on the interim report which had laid down norms for 10 industries.

These norms represent the maximum levels of holding inventory and receivables in each industry. Borrowers are not expected to hold more than that level. If a borrower has managed with less in the past, he should continue to do so. The fixation of these norms is, thus, intended to reduce the dependence of industry on bank credit.





The norms, however, are not to be applied rigidly. The Group has underscored the desirability of flexibility in fixing norms so that where circumstances justify deviations may be permitted. The plausible circumstances in which temporary deviations may be permitted have been listed by the Group in the Report and include: (1) bunched receipt of raw materials including imports; (2) power-cuts, strikes and other unavoidable interruptions in the process of production; (3) transport delays and bottlenecks; (4) accumulation of finished goods due to non-availability of shipping space for exports or other disruptions; (5) build-up of stocks of finished goods such as machinery due to failure on the part of the purchasers, for whom these were specifically manufactured, to take delivery; (6) need to stock raw materials for specific export contracts of a short duration. Moreover, deviations should be allowed for agreed periods and there should be a return to the level of the norm when conditions revert to normal. In other words, the flexibility in inventory and receivable norms should work both ways.

**Lending Norms-**The second category of norms suggested by the Tandon Committee relates to lending. Although the recommendation of the Group relating to inventory norms has attracted the most attention, its recommendation relating to “lending norms” is more basic and has far-reaching implications.

In terms of the “inventory norm” the borrowers are expected to hold only a reasonable level of inventory and receivables. The Study Group has visualized the banker’s main role, as a lender, to supplement the borrower’s resources in carrying a reasonable level of current assets in relation to his production requirements and not to meet his entire working capital needs as was the earlier practice. In the light of this, the Group has suggested a new approach to lending. According to the “lending norm” recommended by the Group, a part of the current assets should be financed by trade credit and other current liabilities. The remaining part of the current assets, which are termed-by the Group as “working capital gap”, should be partly financed by the owner’s funds and long-term borrowings and partly by short-term bank credit. In the context of this approach to lending, the Group has suggested three alternative methods for working out the maximum permissible level of bank borrowings, each successive method reducing the involvement of short-term bank credit to support current assets.

According to the first method, the short-term bank credit will finance a maximum of 75% of the working capital gap, i.e. total current assets less current liabilities other than bank borrowings; the remaining part of the “gap” is to be financed out of long-term funds comprising owned funds and term loans. This method will give a minimum current ratio of 1:1. The second method, stipulates that the



borrowers will provide for a minimum of 25% of total current assets out of long-term funds. A certain level of credit for purchase and other current liabilities will be available and the balance will be provided by the banks. Total current liabilities will be available and the balance will be provided by the banks. Total current liabilities inclusive of bank borrowings will not exceed 75 per cent of the current assets. The current ratio, according to this method, will be 1.3:1 The third method excludes core current assets from total current assets on the theory that core current assets should be financed out of long-term funds. The term “core” refers to the absolute minimum level of raw materials, stock-in-progress, finished goods and stores which are in the pipeline, to ensure continuity of production and constitute a fixed element. The third method would mean a further reduction in bank credit and strengthening of the current ratio.

The quantum of permissible bank finance for working capital according to three alternative methods suggested by Tandon Committee is illustrated in Example.

### Example 10.3

From the following balance sheet of Sumit Limited, determine the maximum permissible bank finance for working capital as per Tandon Committee. Assume core current assets of Rs. 40 lakhs for the firm.

**Balance sheet as at 31st December, Current Year**

<b>Liabilities</b>	<b>Amount (Rs.)</b>	<b>Assets</b>	<b>Amount (Rs.)</b>
Equity share capital	300	Fixed assets	480
Retained earnings	100	Current assets	300
13 % Debentures	200		
Creditors and other outstanding bills	180		
<b>Total</b>	<b>780</b>		<b>780</b>

Also determine current ratios under each method.

### Solution



(I) Maximum, permissible bank finance:

(i) 1st Method:  $0.75 (CA - CL)$

$$0.75 (Rs. 300 - Rs. 180) = Rs. 90 \text{ lakhs}$$

(ii) 2nd Method:  $0.75 CA - CL$

$$[(0.75 \times Rs. 300) - Rs. 180] = Rs. 45 \text{ lakhs}$$

(iii) 3rd Method:  $0.75 (CA - CCA) - CL$

$$[(0.75 (Rs. 300 - Rs. 40) - Rs. 180)] = Rs. 15 \text{ lakhs}$$

(II) **Current ratio**-Assuming the firm avails of bank credit to the maximum permissible limit, the resultant current ratio of the firm consequent to the borrowing under three methods would be:

#### Current Assets

Current Liabilities (including bank borrowings)				
		Rs. 390 lakhs		
(i)	1st Method:	-----	=	1.44: 1
		Rs. 270 lakhs		
		Rs. 345 lakhs		
(ii)	2nd Method:	-----	=	1.53: 1
		Rs. 225 lakhs		
		Rs. 315 lakhs		
(iii)	3rd Method:	-----	=	1.62: 1
		Rs. 195 lakhs		



The Group expressed the view that the third method is ideal as it will provide the largest multiplier of bank finance; the next best method from this viewpoint is the second one. However, to avoid hardship to borrowers it has recommended that a beginning should be made by placing all borrowers on the first method within a year and then moving to the second and third methods in stages in the light of the Reserve Bank's assessment of the prevailing circumstances. The recommendation was applicable to all borrowers having a credit limit of Rs. 10 lakhs from the banking system.

The proposed approach to lending by the Group is virtually significant. It takes into account all the current asset requirements of borrowers, as the banker should actually be concerned with the borrower's total operational needs and not merely inventories or receivables; it also takes into account all the other sources of finance at his command. Another merit of the proposed approach is that it will invariably ensure a positive current ratio and will, thus, keep under check any tendency to "over-trade" with borrowed funds. Finally, the concept of bank credit forming only a portion of the 'working capital gap' could also be used as an instrument for influencing the direction of flow of credit, say, for aligning bank credit with priority industries. The Reserve Bank can, for instance, lay down different scales of financing as a percentage of the working capital gap thereby influencing economic policy, for different classes of industries, the relevant percentage can be comparatively high for high-priority industries and low for low-priority industries.

## 10.4 Check Your Progress

6. Which one of the following is the mode of security provided by banks?
  - (e) Hypothecation
  - (f) Pledge
  - (g) Lien
  - (h) All of the above
2. Factor which generally influences the working capital requirements of a firm is..?
  - (e) Size of business
  - (f) Credit policy
  - (g) Production policy
  - (h) All of the above



3. Charge is a .....Property.
- (a) Immovable
  - (b) Movable
  - (c) Both a & b
  - (d) None of the above
4. Components of working capital include.....?
- (a) Management of Accounts receivable
  - (b) Management of Inventory
  - (c) Management of Cash
  - (d) All of the above
5. Form of credit include....?
- (a) Loan Arrangement.
  - (b) Overdraft Arrangements
  - (c) Cash Credit Arrangement
  - (d) All of the above
6. Net working capital refers to....?
- (a) Total assets minus fixed assets.
  - (b) Current assets minus current liabilities.
  - (c) Current assets minus inventories.
  - (d) None of the above

### **10.5 Summary**

Working capital management involves deciding upon the amount and composition of current assets and how to finance these assets. The speed with which the working capital completes a cycle determines the



requirements of working capital – longer the period of the cycle larger is the requirement of working capital. A number of factors are taken into considerations which generally influence the working capital requirements of the firms. Operating cycle method and assets and liabilities method are used to estimate the working capital requirements. The sources of finance for working capital fall into four categories namely trade credit, bank credit, current provisions of long-bank short-term borrowings and long-term sources. The basic objective of working capital management is to manage the firm's current assets and current liabilities in such a way that a satisfactory level of working capital is maintained. The RBI set up a study group to formulate guidelines for follow up of bank credit in July 1974 under the chairmanship of Sh. P L Tandon. A notable feature of the recommendations of the Tandon Committee relates to the fixation of norms for bank lending to industry.

## 10.6 Keywords

- **Gross Working Capital:** The total of the current assets.
- **Net Working Capital:** The difference between the current assets and current liabilities.
- **Operating Cycle:** It starts with the purchase of raw material and ends with the realization of cash from the sale of finished products.
- **Operating Efficiency:** It relates to the firm's optimum utilization of resources at minimum cost.
- **Hypothecation:** In this method, banks provide credit to borrowers against the security of movable property.
- **Mortgage:** It is the transfer of interest in specific immovable property for securing the payment of money advanced.

## 10.7 Self-Assessment Test

- What do you understand by the term 'working capital'? Discuss the need for and significance of adequate working capital in the successful functioning of small scale enterprises.
- Explain the factors that determine the working capital requirements of a small scale industrial unit.



- Discuss the sources of working capital finance for a small firm.
- You are an entrepreneur planning to setup a small-scale unit catering to everyday provision needs of a large housing complex. How would you assess your working capital requirements and wherefrom such requirements be met?
- Explain the main elements of managing effectively the working capital of small-scale industries.

### 10.8 Answers to check your progress

- 1(d), 2 (d), 3(a), 4 (d), 5(d), 6 (b)

### 10.9 References/ Suggested Readings

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<b>GOVERNMENT SUPPORT TO ENTREPRENEURS: POLICY INITIATIVES FOR ENTREPRENEURIAL GROWTH, INCENTIVES AND SUBSIDIES</b>	

## Structure

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## 11.0 Learning Objectives

After reading this lesson, you will be able to:

- Briefly explain the different Industrial Policies.





- Various incentives and subsidy offered to entrepreneurs in India.
- Explain about subsidized consultancy services.
- Discuss the incentives available to SSI units in backward/ rural industries project areas.
- Describe the main provisions of industrial policy, 1991.

## **11.1 Introduction**

In the post-independence era, the Government had to synchronize and harmonize the twin considerations of rapid industrialization and the parameters of a welfare state. The Plan objective of economic growth with social justice was kept in view in the overall strategy of industrial development. All segments of the industry large, medium and small-were assigned a mutually complimentary role with a view to facilitate an integrated and harmonious growth of Industrial sector as a whole. In the context of the major problems of poverty and unemployment faced by the Indian economy, the development of Small Scale Industries (SSI) was considered essential because of its being labour intensive and having implications for equity, flexibility, capability to contribute to decentralization, to promote entrepreneurship, optimum use of local resources and talents, etc.

## **11.2 Industrial Policy Resolution**

Since independence, a series of six Industrial Policy Resolutions aimed at promoting industrial growth and determining a pattern of State intervention and assistance have been announced by the Central Government. While spelling out the framework of the basic and strategic industries, the Industrial Policy Resolution, 1948, realized Cottage and Small Scale Industries to be particularly suited for better utilization of local resources and achievement of 'local self-sufficiency' in respect of certain types of industrial goods. The policy of supporting the cottage, village and small industries took shape in 1956 when the Government decided to initiate measures to build the competitive strength of small and village industries. The 1956 Resolution underlined the role that the SSI sector could play, in providing employment opportunities, mobilizing local skills and capital resources, and in the integrating process with large industrial sector.

The Industrial Policy Statement, 1977, stressed upon wider dispersal of cottage and small industries in the rural areas and small towns. The concept of District Industries Centres was also mooted so as to



provide services to small industries under one roof. While the Industrial Policy Statement of 1980 was important from the point of view of ancillarisation and creation of nucleus plants for the growth of the sector, that of 1990 emphasised the steps for enhancing the contribution of the SSI Sector in overall exports, employment generation, and dispersal of industries in rural areas.

The Industrial Policy measures announced in 1991 laid special thrust on promotion and strengthening of small, tiny and village industries. Besides effecting changes in investment limits, equity participation, etc., a new scheme of Integrated Infrastructure Development for SSIs with the participation of State Governments and Financial Institutions was initiated and a pro-active role for NGO sector was mooted. In order to protect their interest and facilitate their rapid development, the Government in pursuance of its policies, have initiated a number of support measures from time to time which include policy of reservation, revision of investment ceilings, modernization, technology up gradation, marketing assistance, etc. The emerging economic scenario in the changed liberalized and competitive economic environment has necessitated structural and fundamental changes in the policy framework put into place for the development of this vital sector of the economy. Accordingly, there has been a shift in focus from ‘protection’ to ‘promotion’. In the post reform period, a number of steps including partial dereservation, change in investment limits, facilitating foreign participation, establishment of growth centres, export promotion, marketing assistance and incentives for quality improvement, etc. have been taken by the Government for strengthening of this sector. The highlights of the Small Scale Industries Policy of August 1991 are as follows:

- The investment limit for the tiny sector was raised to Rs. 5 lakhs from Rs. 2 lakhs. This limit has now been raised to Rs. 25 lakhs.
- Here after irrespective of their location would be recognized as small scale industries.
- The Small Industries Development Organization (SIDO) has been recognized as the nodal agency to support the small scale industries, export promotion.
- An export development centre would be set up in SIDO to serve the small scale units through its network of field officers to further augment export activities of the sector.



- A technology development cell (TDC) will be set up in SIDO which could provide technology inputs to improve quality and competitiveness of product of small scale sector.
- The scheme for the handloom sector, which contributed 30% of the total textile production in the country, would be redesigned keeping in view the local and regional needs. It would be the policy of the Government to promote handloom to sustain employment in rural areas and to improve quality of life for handloom weavers.
- The National Small Industries Corporation (NSIC) would concentrate on marketing of mass, consumption items under common brand name and organizational links between NSIC and SSIDCs would be established.
- The scope of the national equity fund scheme will be widened to cover projects up to Rs. 10 lakhs for Equity Support (Up to 15 per cent).
- The Single Window loan scheme has also been enlarged to cover Projects up to Rs. 20 lakhs with working capital margin up to Rs. 10 lakhs.
- Small Scale units can have equity support to the extent of 24% of the total investment from the medium and large scale industries, Public Undertakings, NRIs or foreign investment.

In conformity with the socio-economic objectives of the national development plans, the development banks have introduced a number of promotional innovative schemes to be operated either separately or jointly. Some of the important schemes are soft loan scheme, seed capital assistance, risk capital assistance, concessional schemes, etc. In addition, IFCI is operating different subsidy schemes for new and small entrepreneurs. Recently, it has introduced eight consultancy schemes and four interest subsidy schemes for the benefit of the entrepreneurs.

The SSI Sector has proved its mettle even in the changed liberalized economic environment of the country. The steps required for opening up of the economy have affected the operations of this sector, throwing/open new opportunities and challenges at the same time. The need of the hour undoubtedly is to provide sustenance through suitable measures to strengthen it for converting the challenges into opportunities for scaling new heights.



In order to enable the Government to place more focused attention on the problems of the, SSI Sector, a new Ministry of Small Scale Industries and Agro and Rural Industries has been created on 14th October 1999, under the Independent Charge of a Minister of State. To give a direction -and perspective to the development strategy, the Minister in-charge of Small Scale Industries and Agro & Rural Industries announced an “Agenda for the Millennium” which places special emphasis on evolution of a new policy framework, improved supply of credit, better infrastructural facilities, and impetus for modernization and technology up gradation in small scale industries. The Agenda takes cognizance of the special role to be played by Information Technology, sunrise industries, hi-tech industries, export potent industries, and at the same time stipulates all possible steps to meet the requirements of the tiny and micro-enterprises which constitute over 95 per cent of total small scale industrial units in the country.

Knowing of the crucial role of small enterprises, and the problems being faced by them, the Planning Commission, in 1999, constituted a Study Group under the Chairmanship of Dr. S.P. Gupta, Member, Planning Commission, on Development of Small Enterprises. The Study Group has submitted its report on 13th July 2000.

### **11.2.1 Incentives and Subsidy**

The term “incentive” includes concessions and bounties. ‘Subsidy’ denotes a single lump sum which is given by a government to industry. It is granted to an industry which is considered essential in the national interest. The term ‘bounty’ denotes bonus or financial benefit which is given by a government to an industry to help it compete with other units in a nation or in a foreign market. It is given in proportion to the output. Bounty confers benefits on a particular industry, while a subsidy is given in the interest of the nation.

These subsidies and incentives offer the following advantages:

- They act as motivational force which attracts the prospective entrepreneurs to enter into manufacturing line.
- They encourage the entrepreneurs to start industries in backward areas.
- By providing subsidies and incentives the Government can: (i) bring industrial development uniformly in all regions, (ii) develop more new entrepreneurs which lead to entrepreneurial



development, (iii) increase the ability of entrepreneurs to face competition successfully, and (iv) reduce the overall problems of small scale entrepreneurs.

**Schemes of Incentives in Operation-**Various incentive schemes offered by Central and State Governments including Union Territories to the entrepreneurs in India are as follows:

**Incentives under the Licensing Regulations-**When the controls dominate, a relaxation of the control itself is a significant incentive. A government notification states that the Central Government is of the opinion that directions for further positive production orientations are to be given to the economy to increase production by removing all constraints to the maximum extent possible. Now, therefore, in exercise of powers conferred by Section 29(B) (i) of the Industries (Development and Regulation) Act, 1951, the Central Government hereby exempts all undertakings registered under the said Act from the operation of Section 13(i) (d). “Such exemptions are quite many and resorted to frequently”.

**Incentives for Development of Industries in Backward Areas-**As a part of the measures to ensure balanced regional development, Government of India has announced a number of concessions and facilities for industries established in selected backward districts/areas from time to time. The Central government has declared 247 districts (covering about 70% of the areas in the country) as backward and eligible for the subsidies. Many State Governments have added to this list for the purpose of State level subsidies. The programme of assistance drawn up for setting up industries in the selected backward area/district is briefly indicated below:

- **Concessional finance:** All India financial institutions namely, Industrial Finance Corporation of India and Industrial Credit and Investment Corporation of India, Industrial Development Bank of India, extend financial assistance on concessional terms to all, new and existing industrial projects having expansion schemes irrespective of the project costs located in the 247 districts selected by the government. The concessions given by these financial institutions are in the form of lower interest rate viz., 9.5% p.a. against the normal rate of 11 %, a reduced commitment charge of 0.5% (which could be waived in exceptional cases), lower underwriting commission of 1.25% and 0.75% for shares and debentures respectively, initial moratorium period up to five years, longer amortizations of 15 to 20 years and participation in the risk capital on selective basis. Besides these, the IDBI follows a flexible attitude in respect of promoter's contribution, margin requirements, and



rescheduling of repayments during the tenure of the loan. Depending upon the merits of specific cases in respect of reliance, the IDBI charges a special rate of 6% with the primary lender's rate being subjected to a ceiling of 9.5%. The normal rate of refinance is 6% with ceiling of 12.5% by the primary lending institution.

- **Capital Investment Subsidy:** The granting of cash subsidy on the capital investment is called capital investment subsidy. It will be usually in the form of outright grant of 10% to 20% of the amount of capital invested in the industrial units in areas specified to be backward regions/districts. It is offered by the Central Government. Out of the districts declared backward by the planning commission, 101 districts/areas have been selected to qualify for Central investment subsidy. These districts/areas have been selected on the pattern of six districts/areas for industrially backward states and three districts/areas for other states. The salient features of the scheme are given below:
- **Quantum of subsidy:** When the scheme was originally announced in 1971, 10% of the investment made on fixed capital investment viz., land, building, and plant and machinery, was to be reimbursed as an outright grant subject to a ceiling of Rs. 15 lacs. This was raised to 15% with effect from 1-3-1973. The maximum amount payable is, however, restricted to Rs. 15 lacs per industrial unit. After the division of backward districts into (A), (B) and (C) categories the subsidy will be: (A) 25% subject to a maximum of Rs. 25 lacs; (B) 15% subject to a maximum of Rs. 15 lacs (c) 10% subject to a maximum of Rs. 10 lacs.
- **Eligibility:** Industrial units other than those run departmentally which made investments in land, building, and plant and machinery on or after 1-3-1973 and located in the above category of districts/areas is eligible to claim subsidies. Existing units taking into expansion, modernization and diversification are also eligible to claim subsidy.
- **Procedure for Claiming Subsidy:** The State Governments/Union Territory administrations have nominated disbursing agencies to administer the scheme of investment subsidy. State Financial Corporation and financial institutions such as IDBI, IFCI, and ICICI are some of the agencies selected for disbursements of subsidy under the scheme. Each industrial unit being set up in the specified district gets registered with the Director of Industries for claiming investment subsidy. The units desirous of getting investment subsidy may approach the disbursing agencies that in turn make



recommendation after verification etc. to the State level committee which has been appointed in each State/Union Territory.

### **Tax holiday to new industrial undertakings set up in backward States and Union Territories-**

Under section 80-IA of the Income Tax Act 1961, deduction is allowed in computing the taxable Income in respect of profits derived from new industrial undertaking or a ship or the business of a hotel. The deduction under this section is allowed in the case of companies, at 30 per cent of profits in respect of the assessment year relevant to the previous years in which the hotel starts functioning or the industrial undertaking starts manufacturing or the ship is first brought to use and nine assessment years immediately succeeding the initial assessment year. In the case of taxpayers being a co-operative society, similar deduction is allowed for the initial assessment year and eleven succeeding years, the deduction is allowed at the rate of 25% in the case of non-corporate assesses. Likewise in the case of new hotels set up in a hilly area or a rural area or a place of pilgrimage or such other place as the Central Government may specify, the deduction is admissible at the rate of 50 per cent of the profits.

With a view to giving substantial thrust for encouraging the industrialization in States and Union Territories which are industrially very backward, the Finance Bill proposes to provide incentive for dispersal of industrialization in remote and industrially backward regions. It is proposed to allow, in respect of any new industrial undertaking, located in a State or Union Territory specified in the new Eighth Schedule of the Income-tax Act, which starts manufacturing or production after 1.4.1993, deduction under section 80-IA at the rate of 100 per cent of profits in respect of the first five assessment years starting from the assessment year relevant to the previous year in which the industrial undertaking begins manufacture or production. For the subsequent assessment years, deduction from the profits of such undertakings will be allowed at the normal rate of 30 per cent in the case of companies and 25 per cent in the case of Non-corporate assesses. The deduction, at the enhanced rate and the normal rate together, will be limited to twelve assessment years in the case of co-operative societies and ten assessment years in the case of other assesses, as in the existing provisions.

States and Union Territories which are industrially very backward have been identified as those in which, according to the backward area Notification S.O. No. 165 dated 19-2-1986, all the districts are industrially backward. These States and Union Territories are Arunachal Pradesh, Assam, Goa, Himachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, and



Tripura and the Union Territories of the Andaman and Nicobar Islands, Dadra & Nagar Haveli, Daman & Diu, Lakshadweep, and Pondicherry. The above list corresponds to the existing list of industrially backward areas specified by the Ministry of Industry. The proposed amendments will take effect from 1st April, 1994 and will, accordingly, apply in relation to assessment year 1994-95 and subsequent years.

**Tax holiday for the power sector**-Under section 80-IA of the Income-tax Act, 1961, deduction is allowed, in computing the taxable income, in respect of profits derived from a new industrial undertaking or a ship or the business of a hotel.

With a view to substantially increasing the power generation capacity in the country the Bill proposes to provide for a full tax holiday for five years and there after a partial tax holiday in respect of profits and gains of industrial undertakings set up anywhere in India for generation and distribution of power. Such undertaking which begins to generate power on or after 1-4-1993 will be allowed deduction under section 80-IA, at the rate of 100 percent of profits in respect of the first five assessment years starting from the assessment year relevant to the previous year in which the undertaking begins generation of power. For thy subsequent assessment years, deduction from the profits from such undertakings will be allowed at the normal rate of 30 per cent in the case of companies and 25 per cent in the case of non-corporate assesses. The deduction, at the enhanced rate and the normal rate together, will be limited to twelve assessment years in the case of cooperative societies and ten assessment years in the case of other assesses, as in the existing provisions. The proposed amendments will take effect from 1st April, 1994 and will, accordingly, apply in relation to assessment year 1994-95 and subsequent years.

### 11.2.2 Subsidized Consultancy Services

Small entrepreneurs proposing to set up rural, cottage, tiny or small scale units, or to expand/diversify/modernize their existing units can get consultancy services at a low cost from the technical consultancy organ is at ions (TCO's) sponsored by All India and State level financial and promotional institutions and banks. They have to pay only 20% of the fees charged by a TCO for assignments such as preparation of feasibility studies, project reports, market studies, pre-investment studies, diagnostic studies and special studies and applications for seeking financial assistance from financial institutions technical assistance, etc. The entire balance of 18% or Rs. 5,000 whichever is





lower is subsidized by IFCI in the case of assignments relating to the use of biogas or renewable/alternative sources of energy. For units identified or assignments covering physically handicapped or scheduled caste/tribe entrepreneurs, 100 % of the fees of the TCO for the assignment or Rs. 6,000 whichever is lower is subsidized. If any entrepreneur is unable to take effective steps to set up the project within one year from the date of completion of consultancy assignments he will not be entitled to prevent the use of the report in any form or manner by the TCA or other entrepreneurs. An entrepreneur who has already set up a project at one place and wishes to setup an entirely different project at another place may be considered eligible to subsidy for the second project also. In any case, the subsidy will not be made available to the same entrepreneur for more than two projects.

**Subsidy for Market Studies**-New entrepreneurs (locally based or non resident Indians) entering the field of Medium and/or medium large industry for the first time in the country can have market studies for their products undertaken by TCA at a cheaper cost. The fee for the preparation of a market study payable to TCA would be subsidized by IFCI up to 75% of the cost or Rs. 15,000 whichever is lower. The subsidy will be made available only to the TCA with which one or more financial institutions or Development agencies at the State or All India level are associated as shareholders(s) or member(s) of board of management. The entrepreneur will have to bear only 25% of the cost of the study.

**Adoption of Indigenous Technology**-Promoters of projects involving commercial exploitation of indigenous technology can get assistance in the form of subsidy covering the interest payment due to IFCI during the first three years of operations of the project subject to ceiling of Rs. 5 lakhs a year. In appropriate cases; the total subsidy could be up to Rs. 25 lakhs over a period of five years. The subsidy would be reimbursed to the concern after it makes payments of installments of interest to IFCI on due dates. For being eligible for concessional assistance, the project should be set up with loan assistance from IFCI and be based on indigenous technology. The right to use this technology must have been acquired by the agency implementing the project from the concerned institution, viz. Government laboratories, public sector companies, universities, or any other institution recognized by the Government of India. The technology should be one which has not already been exploited on a commercial scale in the country, and a certificate to this effect will have to be obtained from the concerned institution. The technology should be basic to the manufacture of the proposed product and



not merely peripheral and the project must be of national priority as indicated by government from time to time.

**Special Facilities for Import of Raw Materials-**The Import Policy of 1978-79 has introduced special concession of import of raw materials in the case of industrial units set up in backward areas or by graduates/ diploma holders in professional subjects or by ex-servicemen persons belonging to scheduled castes scheduled tribes. The maximum value of the license shall be Rs. 5 lakhs in respect of new or proposed small scale units instead of Rs. 3 lakhs. They will also be eligible for preferential treatment in the matter of canalized items.

**Transport Subsidy-**The transport subsidy scheme, 1971 envisages grant of a transport subsidy to industrial units in selected areas to the extent of 50% of the transport cost of raw materials which are brought into and finished goods which are taken out of the selected areas.

The scheme covers the State of Jammu and Kashmir, Himachal Pradesh, hilly areas of Uttar Pradesh and North Eastern Region comprising of States of Assam, Meghalaya, Nagaland, Tripura and the Union Territories of Arunachal Pradesh, Andaman and Nicobar Islands, Mizoram and Lakshadweep. Subsidy is paid on transport costs between the selected railheads and location of the industrial units in the above states/Union Territories.

The highlights of the scheme are:

- Industrial units in the above-mentioned areas will be given transport subsidy in respect of the raw materials brought into and the finished goods which are taken out of such areas.
- No transport subsidy will be allowed for the internal movement of raw, materials and finished goods within the State of Jammu and Kashmir and the North Eastern Region.
- In the case of Jammu and Kashmir, the transport subsidy will be given between the railhead at Pathankot and the location of the industrial unit or between the location of the industrial unit and Jammu, whichever is nearer.
- Barring Jammu and Kashmir, the transport subsidy will be given on the transport cost between Siliguri and the location of the industrial unit in the North Eastern States. While calculating the transport cost, the cost from Siliguri to the railway station nearest to the industrial unit will be



taken into account in respect of raw materials and finished goods. If any other mode of transport is used the cost will be limited to the amount which the industrial unit may have paid, if it had used the above mode of transport.

- Freight charges for the movement of goods by road will be determined on the basis of the transport rates fixed by the government of a State/Union Territory from time to time, or the actual freight paid, whichever is less.
- The cost of loading or unloading and other handling charges will be taken into account for the purpose of determining transport costs.
- All new industrial units located in the selected areas will be eligible for a transport subsidy equivalent to 50% of the transport cost of raw materials and finished goods.
- Existing industrial units are also eligible for a 50% subsidy in respect of additional transport costs of raw materials and finished goods resulting from a substantial expansion or diversification effected by them after the commencement of the Transport Subsidy scheme.
- The transport subsidy will cover 50% of the transport charges on the movement of steel from the Gauhati Stockyard of Hindustan Steel Limited to the site of an industrial unit in the North-Eastern Region.
- The Directorates of Industries in the States/Union Territories will lay down system of pre-registration of industrial units which are eligible for the transport subsidy.

### 11.3 Incentives Available to SSI Units in Backward/Rural Industries Project Areas

Certain special facilities and incentives which have been provided to the backward districts are enumerated below:

- An outright subsidy of 15% on the fixed capital investment up to a maximum of Rs. 15 lakhs is admissible to the units being set up in backward areas.
- Allotment of factory or factory sheds in industrial estates/areas and industrially developed colonies on easy terms.



- Interest-free loans in lieu of inter-state Sales tax paid/payable by SSI units are available up to 7 years, provided the loan in a particular year will not exceed 8% of the capital investment.
- The State Financial Corporations grant loans for acquisition of fixed assets up to Rs. 30 lakhs in the case of limited companies and registered co-operative societies and up to Rs. 15 lakhs for others at liberalized margins and rate of interest, and this is done over a longer span of repayment and moratorium period.
- The Central/State Government directly or through its subsidiary concern, the State Industrial Development Corporation-underwrites or participates in the preference shares of public limited companies on a selective basis for setting up medium and large industrial units. The State Government also considers cases for setting up of joint ventures with the private sector.
- The SSI units in the backward areas and other industries with a capital investment in plant and machinery up to Rs. 1 lakh are exempted from the following taxation in some States:
  - New units established in the districts are completely exempted from the payment of electricity duty up to a period of 7 years.
  - New units are exempted from property tax for a period of 5 years.
  - Industrial units set up within the municipal limits are exempted from octroi on capital equipment and, building materials subject to a maximum period of 3 years from the date of regular registration.
- Provision of essential, controlled raw materials to the SSI units on priority and at very liberal terms.
- State Governments have set up independent testing laboratories on behalf of the Indian Standards Institution, the Export Inspection Council, the Department of Defense, Government of India and various other government organisations for making industrial products of good quality.
- In order to provide some important and sophisticated common facilities, a network of industrial development centres, heat treatment centres and common facility workshops have been set up in the States to equip the SSI units with modern techniques and process of manufacturing.



**Seed Capital Assistance**-One of the constraints faced by the entrepreneurs, especially first generation or technical entrepreneurs is the lack of resources to meet the minimum promoter's contribution. To help the entrepreneurs overcome the problem, IDBI has come up with a scheme which has gained popularity as the Seed Capital Schemes. If the project is coming up in non-backward area, then the project would not be eligible for subsidy. Hence, the entire amount of promoter's contribution would be brought by the contributor himself. This would be reduced to the extent of the subsidy if the project is coming up in backward areas like (category A, B, or C). The maximum amount which can be sanctioned is to the extent of Rs. 5 lacs per project on the fulfillment of certain conditions.

**Objectives of the Schedule**-The objective of the scheme is to create new generation entrepreneurs who have the requisite traits of entrepreneurship but whose financial resources are limited. It envisages extension of assistance at a nominal service charge for meeting the risk capital requirements of entrepreneurs. The scheme is expected to promote wider dispersal of ownership and control of industrial undertakings.

**Agencies for Operating the Scheme**-The scheme is operated through the agency of notified SFCs and SFCs. Assistance under the scheme will also be given directly by IDBI in exceptional cases. Projects assisted by commercial banks are also eligible for seed capital assistance. However, the entrepreneurs will have to submit their applications through SFC/SIDC functioning in the region.

### **Eligibility Criteria**

To be eligible for assistance the entrepreneurs should be technically or professionally qualified or possess relevant experience or skills either in industry, business or trade. The following categories of entrepreneurs are eligible for assistance under the scheme:

- New generation entrepreneurs in small scale sector requiring seed capital of more than Rs. 4 lacs.
- Small scale entrepreneurs who undertake expansion/diversification or modernization.
- Entrepreneurs intending to graduate from the small scale to medium sector for the first time.
- Entrepreneurs intending to set up a project in the medium sector for the first time.



- Entrepreneurs already in medium sector and intending to undertake diversification for achieving better viability.
- Entrepreneurs seeking additional seed capital to meet project cost over run caused by factors beyond the control.
- Entrepreneurs intending to take over an existing sick or closed units and projects constituted as public/private limited companies or partnership/ proprietary concerns eligible for assistance.

**Amounts and Mode of Assistance-**The amount of seed capital assistance for project shall not exceed Rs. 15 lacs. However, the actual amount will be determined on the basis of gap in the equity required for the project as also shortfall, if, any in the prescribed minimum promoter's contribution after taking into consideration his own contribution and from other sources and subsidies and incentives. For deciding the quantum of assistance, the debt equity norms of 2:1 in the case of SSI units and 1.5:1 in the case of medium scale units would be adopted. The assistance will be in the form of soft loans in the case of proprietary and partnership concerns. In the case of private limited companies the assistance will be by the way of soft loans or subscription to 1% cumulative redeemable preference shares. In the case of public limited companies the assistance will be normally by way of subscription to, equity capital or cumulative redeemable preference's shares (at 1%) or both or by way of soft loans.

The soft loan would be interest free which will carry a service charge of 1% per annum. However, IDBI may have option to charge the interest on soft loan at a different rate. There is no commitment charge. The repayment period depends upon repaying capacity of the unit with an initial moratorium period not exceeding 5 years. No security except the personal guarantee of the promoter is stipulated.

### 11.3.1 Industrial Licensing: July 1991 Changes

The process of liberalization got a fillip with the announcement of the new industrial policy in July 1991. The major provisions relating to industrial licensing in this policy can be summarized as follows:

- Industrial licensing will be abolished for all projects except for a short list of 18 industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons, and items of elitist consumption.



- In projects where imported capital goods are required, automatic clearance will be given in case where foreign exchange available is ensured through foreign equity or where the CIF value of imported capital goods required is less than 25% of total value of plant and equipment, up to maximum value of Rs. 2 crore.
- The system of phased manufacturing programmes run on an administrative case by case basis will not be applicable to new projects. Existing projects with such programmes will continue to be governed by them
- Existing units will be provided a new broad banding facility to enable them to produce any article without any additional investment.
- The exemption from licensing will apply to all substantial expansions of existing units.
- All existing registration schemes will be abolished.
- Entrepreneurs will henceforth be required to file an information memorandum on new projects and substantial expansions.
- The mandatory convertibility clause will no longer be applicable for term loans from the financial institutions for new projects.

### Taxation Benefits

The taxation benefits available to small scale industries are explained below:

- **Tax Holiday:** New small scale industries are exempted from the payment of income tax under Section 80J of the Act on their profits up to 6% (7.5% for companies) from the total income of the units in the assessment year in which the units began manufacturing, provided the small scale units have followed the procedures laid down in Section 80J. This tax holiday is available up to 5 years from the commencement of production.
- **Depreciation Allowance:** Under Section 32 of the Income Tax Act, a small scale industry is eligible to get a deduction on depreciation account of plant and machinery, land and buildings, at the prescribed rates. In the case of small scale industries the deduction from the actual cost of plant and machinery is allowed up to Rs. 20 lakhs. The depreciation is calculated on the reducing balance



system. Full depreciation is available for a year irrespective of the actual number of days for which the assets have been used. Sometime, an additional allowance, called extra shift allowance is available to the units. Any machinery or plant costing less than Rs. 750 is allowed to be written off completely in the year in which it is first used.

➤ **Development Rebate:** In respect of new plant and machinery other than office appliances or road transport vehicles of a small scale unit, which is wholly used for the purpose of production, a sum, by way of development rebate, as specified below, is allowed under Section 33, in addition normal depreciation.

- In the case of plant and machinery, 35% of the actual cost if it were installed before 1st April 1970, and 25% of such cost if it were installed after 31st March 1970.
- Where the plant and machinery was installed after 31st March 1967, being an asset representing expenditure of a capital nature on scientific research related to the business carried on by a unit, development rebate is given at the specified rates.

➤ **Rehabilitation Allowance:** This is granted to small scale units, under Section 33B, whose business has been disturbed by:

- Riot or civil disturbance.
- Floods, hurricanes, cyclones, earthquakes or other natural disasters.
- Accidental fire or explosion.
- Action by an enemy.

The small scale unit re-established, reconstructed or revived, is allowed a deduction of a sum, by way of rehabilitation allowance, equivalent to 60% of the amount of the deduction allowance to the unit.

**Publication of Books:** A small scale industry engaged in the business of publication of books is entitled to claim a deduction of a sum equal to 20 per cent of the profits and gains derived from such business under section 80 of the Act. “Books” for the purpose of this Section do not include newspapers, journals, Magazines, diaries, brochures, pamphlets and other publication of similar nature.





**Tax Benefits for Amalgamation of Sick Units:** Sickness in an industry, whether large or small, is quite widespread in the country and has become a national problem which has caused a great deal of concern. It is estimated that the aggregate amount involved in the sick units is more than Rs. 2000 crores. The policy of the government has been to encourage the amalgamation of sick units and concessions have been announced to induce healthy units to take over sick concerns in the public interest. Tax concessions are available for the amalgamation of sick units.

### 11.3.2 Incentive to the Small Scale/Ancillary Units Acquiring ISO 9000 Certificate

Government of India launched a Scheme in March, 1994 to give incentive to small scale/ancillary units acquiring ISO-9000 certification or its equivalent. According to the present norms, the Scheme provides for reimbursement of charges for acquiring ISO-9000 (or its equivalent) certification to the extent of 75% of the cost subject to a maximum of Rs. 75,000/- in each cases.

The present procedural norms of submitting copies of various documents like vouchers/receipts of payment made to the certification agencies & consultants etc. along with the application to claim reimbursement have been reviewed, and simplification in these norms has now been introduced. According to the revised procedural norms, a certificate from the Chartered Accountant certifying the expenditure incurred towards Application fee, Assessment/Audit fee, Annual fee/ License fee, Training, Technical Consultancy etc. (excluding hotel & travel expenses) in acquiring 180-9000 certification shall be submitted in place of the certified copies of various vouchers/receipts of payments. Further the Application Form has also been simplified. The revised norms shall reduce their documentation work by the small/ancillary units to a great extent & would also accelerate processing of reimbursement applications.

The revised norms are as under:

- 75% of the cost of acquiring of ISO-9000 certification or its equivalent subject to a maximum of Rs. 75,000 would be reimbursed in each case.
- The scheme of reimbursement will remain in operation till end of 9th plan i.e. upto 31st March, 2002.



➤ The small scale units seeking reimbursement of cost for acquiring ISO-9000 certification under revised norms, continue to file application (as per revised format) with the Development Commissioner (SSI), Minister of Small Scale Industries & Agro and Rural Industries, Nirman Bhavan, New Delhi-110011 alongwith the, following documents:

- Permanent Small Scale Ancillary Registration Certification issued by DIC/State Directorate of Industries, Certified copy.
- Proof of SSI status of the unit as on date of application by submitting the following documents – either (a) or (b)
  - A certificate (in original) from State DI/GM, DIC to the effect that the unit is in SSI sector in terms of investment limits (original purchase value or machinery and equipment) as prescribed by Govt. on the date of submission of application for reimbursement.
    - or
  - An affidavit (in original) from Managing Director/Director/Proprietor/Partner of the SSI unit to the effect that the unit still continues to be a SSI/ancillary unit, accompanied by a CA certificate indicating the total investment in Plant & Machinery as on date.
- ISO-9000 Certification (or its equivalent-attested copy).
- Chartered Accountant Certificate in support of payments made for acquiring ISO-9000 Certification or equivalent (excluding hotel & travel expenses).
- An Undertaking/declaration (in original) giving details of the amount(s) claimed or received by way of grant/reimbursement for acquiring ISO-9000 (or its equivalent) from a State Govt. or any financial institution. The declaration should also be filed stating that the unit shall disclose the reimbursement made by the Central Government (Office of DCSS) at the time of claiming reimbursement, if any, under any other similar scheme run by the Central/State Government/Financial Institution etc.

The revised Application Format along with Formats of undertaking and CA certificates may be had from the General Manager of the District Industries Centre.

**Credit Link Capital Subsidy Scheme for Technology up gradation of SSIs-Guidelines**

- **Title-**The Scheme is called the “Credit linked Capital subsidy Scheme for Technology Up gradation of the Small Scale Industries” (SSI).
- **Purpose-**The scheme will provide 12 per cent back ended Capital Subsidy on projects of technology up gradation by SSI units in the specified products/sub-sectors.
- **Scope of the Scheme-**To begin with, the Scheme would cover the following products/sub-sectors in the SSI:
  - Leather and Leather Products including Footwear and Garments;
  - Food Processing;
  - Information Technology (Hardware);
  - Drugs and Pharmaceuticals;
  - Auto Parts and Components;
  - Electronic Industry particularly relating to Design and Measuring;
  - Glass and Ceramic items including Tiles;
  - Dyes and Intermediates;
  - Toys;
  - Tyres;
  - Hand Tools;
  - Bicycle Parts; and
  - Foundries-Ferrous and Cast Iron.

The above list of products/sub-sector would be expanded as the Scheme progress with the approval of the Technical Advisory Committee constituted under this Scheme.

- **Type of Unit to be covered**



- Existing SSI unit registered with the State “Directorate of Industries which upgrade with the state-of-the-art technology with or without expansion.
- New SSI units which are registered with the State, Directorate of Industries and which set up their facilities only with the appropriate eligible and proven technology duly approved by the Technical Advisory Committee.

➤ **Definition of Technology Up gradation**

- Technology up gradation would ordinarily mean induction of state-of-the-art or near state-of-the-art technology. In the case of more than 7500 products being produced in the Indian small scale sector, technology up gradation would mean a significant step from the present technology level to a substantially higher one involving improved productivity, or/and improvement in the quality of products or/and improved environmental conditions. It would include installation of improved packaging techniques as well as anti-pollution measures and energy conservation machinery.
- Replacement of existing equipment/technology with the same equipment technology will not qualify for this Scheme, nor would the Scheme be applicable to units upgrading with second hand machinery.

➤ **Duration of the Scheme**-The Scheme will be in operation for a period of five years from 1.10.2000 to 30.9.2005, or till the time sanctions of capital subsidy by the Nodal Agency reaches Rs. 600 crores, whichever is earlier.

➤ **Nodal Agency**-Small Industries Development Bank of India (SIDBI) will act as the Nodal Agency.

➤ **Cap on Amount of Subsidy**

- The financial assistance by the Banks/SIDBI for technology up gradation will be need based. However, the subsidy support would be limited to the loan amount indicated in Table I.
- Value of Plant & Machinery being acquired under the Scheme will be determined by its purchase price.



- Capital Subsidy under this Scheme will not be admissible for loan amount exceeding the limits indicated above.
- **Working capital requirement**-Since the success of the technology up gradation programme, to a large extent, depends upon the availability of adequate working capital, commercial banks should provide adequate working capital.
- **Other Conditions for Loans**
  - Promoters' contribution, security, debt-equity ratio, up-front fee, etc., will be determined by the lending agency as per its existing norms.
  - Entrepreneurs availing Credit Linked Capital Subsidy for technology up gradation shall not avail any other benefit including Interest Subsidy, under any other Scheme of the Central Government.

Table-I

Sr. No.	Existing Investment Limit	Maximum Ceiling of Loan eligible for support
1	Tiny units with investment in plant and machinery less than Rs. 10 lakhs.	Rs. 8 lakhs
2	Tiny units with investment in plant & machinery between Rs. 10 lakhs to Rs. 25 lakhs.	Rs. 20 lakhs
3	SSI units with investment in plant & machinery above Rs. 25 lakhs.	Rs. 40 lakhs

- One of the main requirements of sanction of assistance under the Technology Up gradation Scheme will be availability of competent management to the unit concerned to carry out the up gradation programme and to manage the operation of the unit efficiently. Towards this end, the lending agencies may stipulate conditions as may be considered necessary.
- **Procedure for Sanctions and Disbursements of Loans**-The SSI unit will have to apply for financial assistance in the prescribed form to any scheduled Commercial Bank or SIDBI or one of



the declared eligible State Financial Corporations (SFCs). The list of eligible SFCs would be finalized in consultation with the Banking Division, Ministry of Finance. The bank/SFC after appraisal would refer the cases to the SIDBI, which would convey clearance for capital subsidy. The lending institutions would be required to lodge claims of capital subsidy from SIDBI on a quarterly basis. SIDBI will settle the claim expeditiously.

➤ **Procedure for Sanction and Release of Subsidy**

- In order to get the Scheme operationalized, an interest free advance of Rs. 30 crores will be given to SIDBI by the Ministry of SSI&ARI, Govt. of India. The entire subsidy amount of Rs. 600 crores would be released in suitable installments to SIDBI and for which necessary provision would be made in the Annual Plan Budget of the Office of The Development Commissioner (SSI).
- SIDBI would prescribe the modalities for submission of subsidy claims by Commercial banks/State Financial Corporations.
- The detailed methodology of the release and adjustments of subsidy shall be worked out in consultation with the SIDIU.
- The SIDBI shall maintain and monitor fund utilization under the Scheme.

➤ **Preferential Sanction/Disbursement for the Tiny Sector-SIDBI/all Scheduled Commercial Banks/eligible State Financial Corporations would ensure preference to the tiny sector for loans for technology upgradation.**

➤ **Monitoring of the Scheme-Constitution of a Governing Board-**The Scheme will be monitored by a Governing Board. The Secretary (SSI&ARI) will be the Chairperson of the Board and the Development Commissioner (SSI) will be its Member Secretary. The Governing Board shall consist of representatives of Banking Division (Ministry of Finance), Planning Commissioner, Department of Science and Technology, Council of Scientific & Industrial Research. Indian Council for Agricultural Research, SIDBI, some selected public sector banks and some selected small scale



industries associations as members. The governing Board will monitor and review the functioning of the Scheme and will meet at least twice a year.

➤ **Review of approved technologies Constitution of a Technical Advisory Committee**

- Identification of technology is a continuous process. Moreover, new technologies may also come during the operation of the Scheme.
- The Technical Advisory Committee would be set up under the Chairmanship of Secretary (SSI&ARI) to identify the state-of-the-art technology and benchmark existing and new technologies which will be eligible for support under the Scheme. It will consist of representatives of concerned Ministries including Planning Commission, Technical Research Institutes/Organisations such as Council of Scientific & Industrial Research, Department of Science and Technology, National Research Development Corporation, Indian Council for Agricultural Research and Industry Associations. The Development Commissioner (Small Scale Industries) will be the Member-Secretary of the Technical Advisory committee. The Committee would periodically meet and identify the new technologies for approval under this Scheme.

➤ **Estimated Requirement of Funds**

- As credit linked capital subsidy is to be provided for loans of Rs. 5000 crores during the five years of its operation, total liability of Government would be Rs. 600 crores (12% of Rs. 5000 crores) under this scheme.
- For the purpose of estimating the yearly financial requirements it has been assumed that in a year about 15,000 units would be assisted under the Scheme.
- Based on this, the estimated Year-wise funding requirements during the operation of the Scheme is as follows:

<b>Year</b>	<b>Loan Amount to be covered for subsidy (Rs. in cores)</b>	<b>Credit Linked Capital Subsidy (Rs. In crores)</b>
2000-2001	500	60
2001-2002	1000	120



2002-2003	1000	120
2003-2004	1000	120
2004-2005	1000	120
2005-2006	500	60
<b>Total</b>	<b>5000</b>	<b>600</b>

### 11.4 Check Your Progress

1. The term “incentive” includes.....?
  - (a) Concessions
  - (b) Bounties
  - (c) Both a & b
  - (d) No of the above
2. Which one of the followings is incentive available to SSI units in backward/rural industries project areas?
  - (a) An outright subsidy.
  - (b) Allotment of factory or factory sheds.
  - (c) Interest-free loans
  - (d) All of the above
3. Which one of the followings is the eligible criteria for assistance the entrepreneurs?
  - (a) Small scale entrepreneurs who undertake expansion/diversification or modernization.
  - (b) Entrepreneurs intending to graduate from the small scale to medium sector for the first time.
  - (c) Entrepreneurs intending to set up a project in the medium sector for the first time.
  - (d) All of the above
4. The taxation benefits available to small scale industries are.....?





- (a) Tax holidays
- (b) Depreciation Allowance
- (c) Development Rebate
- (d) All of the above

5. On which product “Credit linked Capital subsidy Scheme for Technology Up gradation of the Small Scale Industries” scheme is applied?

- (a) Leather and Leather Products including Footwear and Garments
- (b) Food Processing
- (c) Information Technology (Hardware)
- (d) All of the above

6. Which one of the followings is the incentive for development of industries in backward areas?

- (e) Concessional Finance
- (f) Capital Investment subsidy
- (g) Both a & b
- (h) None of the above

### **11.5 Summary**

The development of any sector in the economy is governed by the policy instruments of the Government. However, policy instruments need to be developed which do not just protect SSI's indiscriminately but help them in a dynamic and changing environment. This would result in more efficient firms which are able to exploit the opportunities for growth. The main objective of Industrial Policy, 1991 is to inject higher degree of vitality and growth impetus to SSI sector in order to attain a higher growth rate in respect of its output.

Knowing of the crucial role of small enterprises, and the problems being faced by them, the Planning Commission, in 1999, constituted a Study Group under the Chairmanship of Dr. S.P. Gupta, Member, Planning Commission, on Development of Small Enterprises. The Study Group has submitted its report



on 13th July 2000. Small entrepreneurs proposing to set up rural, cottage, tiny or small scale units, or to expand/diversify/modernize their existing units can get consultancy services at a low cost from the technical consultancy organ is at ions (TCO's) sponsored by All India and State level financial and promotional institutions and banks

Various incentive schemes have been offered by Central and State Governments to the entrepreneurs in India. Small entrepreneurs proposing to set up a unit can get consultancy services at a low cost from the technical consultancy organ. Special facilities and incentives have been provided to the backward districts in India. Government of India also gives incentive to SSI units acquiring ISO 9000 certification or equivalent.

## 11.6 Keywords

- **Incentive:** Something that encourages to do some risky project.
- **Institutional Support:** It refers to the economic environment of industry and business comprising authorities and institutions whose decisions and operational framework affect the level of business.
- **Subsidy:** A single lump sum which is given by a Government to industry.
- **Capital Investment Subsidy:** The granting of cash subsidy on the capital investment is called capital investment subsidy.
- **Taxation Holiday:** A tax holiday is a government incentive program that offers a tax reduction or elimination to businesses.
- **Consultancy Services:** It means the provision of expertise or strategic advice that is presented for consideration and decision-making.
- **Industrial Policy:** An industrial policy (IP) or industrial strategy of a country is its official strategic effort to encourage the development and growth of all or part of the economy, often focused on all or part of the manufacturing sector.
- **Small Scale Industry:** Small scale industries are those industries in which the manufacturing, production and rendering of services are done on a small or micro scale.



- **Indigenous Technology:** technological knowledge, skills, and resources transmitted or handed down from the past indigenous people to the present ones to meet their needs and wants.
- **Seed Capital:** Seed capital is the money raised to begin developing an idea for a business or a new product.
- **Bounty:** Bonus or financial benefit given by a Government to an industry to help it compete with other units in a nation or in a foreign market.

### 11.7 Self-Assessment Test

- What do you mean by incentives and subsidies? Briefly present an account of the schemes of incentives in operation in India.
- Explain the different incentives available to SSI units in backward areas.
- What do you mean by seed capital assistance? Who are eligible to avail it?
- Write a note on :
  - Subsidized Consultancy Services.
  - Salient features of New Small Enterprise Policy, 1991.
  - Taxation benefits are enjoyed by SSIs.
  - Credit Linked Capital Subsidy Scheme for Technology Upgradation of SSIs”.
- What is meant by transport subsidy? List the main features of this scheme.
- State the changes made in July 1991 in Industrial Licensing.
- Discuss the scheme of Incentives to the small scale/ancillary units acquiring ISO 9000 certificate.

### 11.8 Answers to check your progress

- 1(c), 2 (d), 3(d), 4 (d), 5(d), 6 (c)

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<b>INSTITUTIONAL SUPPORT TO ENTREPRENEURS</b>	

## Structure

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## 12.0 Learning Objectives

After going through the present lesson, you will be able to:

- Enlist the various agencies providing institutional support to entrepreneurs.
- Describe the role of various agencies providing institutional support to entrepreneurs.

## 12.1 Introduction

Governments - both Central and State, have in the past taken a number of measures for the development of small and medium enterprises. Government has set up a number of development institutions to



support entrepreneurs. Some of the institutions assisting entrepreneurs include District Industries Centres (DICs) and Industrial Estate, Small Industries Development Organisation (SIDO), Small Industries Service Institutes (SISI), Small Industry Development Corporation (SIDCO), Entrepreneurial Guidance Bureau (EGB), National Alliance of Young Entrepreneurs (NAYE), National Productivity Council (NPC) and Venture capital funds (VCF). In addition, all India financial institutions-IDBI, IFCI, ICICI-have promoted/sponsored a number of Technical Consultancy Organisations (TCOs) to assist small entrepreneurs in different ways. Recently, the Small Industries Development Bank of India (SIDBI) has been established to help small scale units. Besides, agencies like Khadi and Village Industries Commission, Commercial Banks, Cooperative Banks, EXIM Bank and National Science and Technology Entrepreneurship Board undertake promotional activities aiming at support in entrepreneurship development. Now, what follows in the subsequent pages is the various kinds of support provided by aforesaid institutions to the entrepreneurs to help them establish industries.

## **12.2 Small Scale Industries Board (SSIB)**

The Government of India constituted a Board, namely, Small Scale Industries Board (SSIB) in 1954 to advise on the development of small scale industries in the country. The SSIB is also known as Central Small Industries Board. The range of developmental work in small scale industries involves several departments/ministries and several organs of the Central/State Governments. Hence, to facilitate co-ordination and inter-institutional linkages, the Small Scale Industries Board has been constituted. It is an apex advisory body constituted to render advice to the Government on all issues pertaining to the development of small-scale industries.

The Industries Minister of the Government of India is the Chairman of the SSIB. The SSIB comprises of 50 members including State Industry Minister, some Members of Parliament, and Secretaries of various Departments of Government of India, financial institutions, public sector undertakings, industry associations and eminent experts in the field.

### **12.2.1 State Small Industries Corporations**

Many State Governments have set up Small Industries Corporations in order to undertake a number of commercial activities. The most important of these activities are distribution of scarce raw materials, supply of machinery on hire-purchase basis, constitution and management of industrial estates,



procurement of orders from Government Departments, assistance in export marketing and in certain cases provision of financial, technical and managerial assistance to small enterprises.

### **12.2.2 Small Industries Development Corporation (SIDCO)**

In Tamil Nadu, SIDCO is the state small industries corporation. It plays a lead role in developing small scale sector. It provides the following facilities to small scale units:

- It makes provision of constructed sheds/plots in industrial estates. These are sold to entrepreneurs on hire-purchase basis or given on rental basis.
- Assistance in procuring some scarce key raw materials like iron and steel, paraffin wax, potassium chlorate, Fatty Acids, etc., through its various distribution centres.
- Financial assistance in the form of subsidies to industrial units in backward areas like Central Investment subsidy, state capital subsidy. Interest-Free sales tax loans, power tariff subsidy and margin money assistance for the rehabilitation of the sick small scale industries.
- Marketing assistance to small entrepreneurs.

### **12.2.3 Small Industries Service Institutes (SISIs)**

The Small Industries Services Institutes (SISIs) are set up to provide consultancy and training to small entrepreneurs-both existing and prospective. The activities of SISIs are coordinated by the Industrial Management Training division of the DCSSI's office. There are 28 SISIs and 30 branch SISIs set up in State capital and other places all over the country.

#### **The main functions of SISIs include**

- To serve as interface between Central and State Governments.
- To render technical support services.
- To conduct Entrepreneurship Development Programmes.
- To initiate promotional programmes.

The SISIs also render assistance in the following areas:

- Economic Consultancy/Information/EDP Consultancy.



- Trade and market information.
- Project profiles.
- State industrial potential survey.
- District industrial potential surveys.
- Modernization and in plant studies.
- Workshop facilities.
- Training in various trade/activities.

#### 12.2.4 District Industries Centers (DICs)

The District Industries Centres (DICs) were established in May 1978 with a view to provide integrated administrative framework at the district level for promotion of small-scale industries in rural areas. The DICs are envisaged as a single window interacting agency with the entrepreneur at the district level. Services and support to small entrepreneurs are provided under a single roof through the DICs. They are the implementing arm, of the Central and State Governments for various schemes and programmes. Registration of small industries is done at the district industries centres.

The organisational structure of DICs consists of General Manager, four Functional Managers and three Project Managers to provide technical service in the area relevant to the needs of district concerned. Management of the DIC's is done by the State Governments. The scheme has now been transferred to the states and from the year 1993-94, funds will not be provided by the Central Government to the States for running the DICs.

**Functions:** The DICs role is mainly promotional and developmental. To attain this, they have to perform the following main functions:

- To conduct industrial potential surveys keeping in view the availability of resources in terms of material and human skill, infrastructure, demand for product, etc.
- To prepare techno-economic surveys and identify product lines and then to provide investment advice to entrepreneurs.





- To prepare an action plan to effectively implement the schemes identified.
- To guide entrepreneurs in matters relating to selecting the most appropriate machinery and equipment, sources of its supply and procedure for procuring imported machinery, if needed, assessing requirements for raw materials etc.
- To appraise the worthiness of the various proposals received from entrepreneurs.
- To assist the entrepreneurs in marketing their products and assess the possibilities of ancillarisation and export promotion of their products.
- To undertake product development work appropriate to small industries.
- To conduct artisan training programmes.
- To function as the technical arms of DRDA in administering IRD and TRYSEM programmes.

### 12.2.5 Industrial Estates

Developing countries require institutional arrangements for their rapid industrialization and balanced growth. One such institutional measure is industrial estates. The term 'industrial estate' is called by different names, e.g., industrial park, industrial zone, industrial region, industrial city, industrial area, Industrial Township, etc.

An industrial estate has been defined as a method of "organising, housing and servicing industry, a planned clustering of industrial enterprises offering standard factory building erected in advance of demand and a variety of services and facilities to the occupants". In other words, an industrial estate is a tract of land sub-divided and developed according to a comprehensive plan for the use of a community of industrial enterprises. It is a planned clustering of industrial units offering standard factory buildings and a variety of services and facilities to entrepreneurs.

### Types of Industrial Estates

Industrial estates are classified on various bases. The prominent ones are:

- **Classification on the basis of Functions:** On the basis of functions industrial estates are broadly classified into two types: (i) General type industrial estates, and (ii) Special type industrial estates.



- **General Type Industrial Estates:** These are also called as conventional or composite industrial estates. These provide accommodation to a wide variety and range of industrial concerns. The Indian industrial estates are mainly of this type.
- **Special Type Industrial Estates:** These types of industrial estates are constructed for specific industrial units, which are vertically or horizontally interdependent.
- **Classification on the basis of Organisational Set-up:** On this basis, industrial estates are classified into following four types:
  - Government Industrial Estates,
  - Private Industrial Estates,
  - Co-operative Industrial Estates, and
  - Municipal Industrial Estates.
- **Other Classifications**
  - **Ancillary Industrial Estates:** In such industrial estates, only those small-scale units are housed which are ancillary to a particular large industry. Examples of such units are like one attached to the HMT, Bangalore.
  - **Functional Industrial Estates:** Industrial units manufacturing the same product are usually housed in these industrial estates. These industrial estates also serve as a base for expansion of small units into larger units.
  - **The Workshop-bay:** Such types of industrial estates are constructed mainly for very small firms engaged in repair work.

### Objectives of Industrial Estates

The main objectives of the establishment of industrial estates are:

- To provide infrastructure and accommodation facilities to the entrepreneurs;
- To encourage the development of small-scale industries in the country;
- To decentralize industries to the rural and backward areas;



- To encourage ancillarisation in surrounding major industrial units; and
- To develop entrepreneurship by creating a congenial climate to run the industries in these estates.

### **Industrial Estates in India**

One of the handicaps faced by small scale industries in India has been the lack of well-developed space with the necessary infrastructure for carrying on their manufacturing operations. In order to overcome this problem, the Government of India launched the programme of setting up industrial estates in 1955. The responsibility for planning, developing, constructing and managing industrial estates lies with the respective State Governments. They are free to run the estates through corporations or any other agencies of their choice. The Central Government provides financial assistance to the State Governments for the development of industrial estates. Such financial assistance is provided in the form of loans, grants and subsidies.

Industrial estates as a tool of rapid and balanced economic development, occupy a prominent place in the scheme of planned growth in India. These estates are expected to foster the growth of small scale industries, help in rural industrialization and decentralization of industrial location. Therefore, increasingly more funds have been allocated under successive five year plans for the development of industrial estates. Such allocation of funds increased from Rs. 58 lakhs under the First Five Year Plan to more than Rs. 90 crores in the Eighth Five Year Plan.

The programme of industrial estates in India is designed to achieve the following objectives:

- to encourage the development of small-scale and medium sized industrial units for balanced regional development;
- to remove concentration or congestion of industries in big cities by facilitating the movement of industrial units to suburban and rural areas;
- to secure decentralization of industry by diverting new industrial units to underdeveloped regions;
- to encourage the growth of ancillary units in the townships surrounding major industrial undertakings, both in public and private sectors. No developing country has launched such a



massive programme of industrial estates as India. Over the years there has been a remarkable growth in industrial estates. However, a sizeable portion of capacity in industrial estates remains unutilized.

Experience reveals that urban industrial estates have been more successful than semi-urban and rural estates. Rural estates have not been much successful due to lack of sound infrastructural facilities. Therefore, efforts should be made to develop sound infrastructure in rural and suburban industrial estates.

Small industry certainly needs a boost through industrial estates. But industrial estates should not simply become a housing colony for small units, irrespective of their merits. Encouraging the small units that do not fit into the nation's needs and the national priorities is pointless. Identification of the product, manufacturing of which results in the promotion of labour - intensive industry and choosing the techniques that help promote the labour - and intensive manufacturing should be the objectives of the industrial estates.

#### **12.2.6 National Small Industries Corporation Ltd. (NSIC)**

The National Small Industries Corporation Ltd. (NSIC), an enterprise under the Union Ministry of Industries, was set up in 1955 to promote, and foster the growth of small scale industries in the country. NSIC provides a wide range of services, predominantly promotional in character to small scale industries. Its main functions are:

- To provide machinery on hire-purchase scheme to small scale industries.
- To provide equipment leasing facility.
- To help in export marketing of the products of small scale industries.
- To develop proto-type of machines and equipments to pass on to small scale industries for commercial production.
- To distribute basic raw material among small scale industries through raw material depots.
- To help in the development and upgradation of technology and implementation of modernization programmes of small scale industries.



- To impart training in various industrial trades.
- To undertake the construction of industrial estates.

### **12.2.7 Small Industries Development Organization (SIDO)**

Small Industries Development Organisation (SIDO) is a subordinate office of the Department of SSI & ARI. It is an apex body and nodal agency for formulating, coordinating and monitoring the policies and programmes for promotion and development of small-scale industries. Development Commissioner is the head of the SIDO. He is assisted by various directors and advisers in evolving and implementing various programmes of training and management consultancy, industrial investigation, possibilities for development of different types of small-scale industries, development of industrial estates, etc. The main functions of SIDO are classified into (i) co-ordination, (ii) industrial development and (iii) extension. These functions are performed through a national network of institutions and associated agencies. All small-scale industries except those falling within the specialised boards and agencies like KVIC, Coir Boards, Central Silk Board, etc. fall under the purview of the SIDO.

Following are the main tasks performed by the SIDO in each of its three categories of functions.

#### **Functions Relating to Co-ordination**

- To evolve a national policy for the development of small scale industries,
- To co-ordinate the policies and programmes of various State Governments,
- To maintain a proper liaison with the related Central Ministries, Planning commission, State Governments, Financial Institutions, etc., and
- To co-ordinate the programmes for the development of industrial estates.

#### **Functions Relating to Industrial Development**

- To reserve items for production by small-scale industries,
- To collect data on consumer items imported and then, encourage the setting of industrial units to produce these items by giving coordinated assistance,
- To render required support for the development of ancillary units, and



- To encourage small scale industries to actively participate in Government Stores Purchase Programme by giving them necessary guidance, market advice and assistance.

### **Functions Relating to Extension**

- To make provision of technical services for improving technical process, production planning, selecting appropriate machinery, preparing factory layout and design.
- To provide consultancy and training services to strengthen the competitive ability of small-scale industries.
- To render marketing assistance to small-scale industries to effectively sell their products, and
- To provide assistance in economic investigation and information to small scale industries.

### **12.2.8 Entrepreneurial Guidance Bureau (EGB)**

The EGB has, been set up to guide entrepreneurs in identifying investment opportunities, assisting them in selecting locations or the projects, preparing project profiles, assisting them to get financial assistance.

EGB has been supplying information pertaining to the products that offer scope for manufacture, statistical details relating to demand, capacity production, sources of raw materials, types of equipments required, investment involved, sources of finance, etc. Information of procedures pertaining to obtaining letters of intent, import of capital equipment, and export of finished products is also furnished. EGB also renders assistance from banks/financial institutions or for submitting proposals for the letter of intent, etc. EGB also establishes direct contact with engineering graduates, technically qualified personnel and small entrepreneurs to promote entrepreneurship development.

### **12.3 National Alliance of Young Entrepreneurs (NAYE)**

National Alliance of Young Entrepreneurs (NAYE) sponsored an Entrepreneurial Development Scheme with Bank of India in August 1972 on pilot basis. This scheme, known as BINEDS, is operative in the States of Punjab, Rajasthan, Himachal Pradesh, Jammu and Kashmir and Union Territories of Chandigarh and Delhi. NAYE entered into similar arrangements with a few other banks as are discussed below.



- **Dena Bank - NAYE:** For Promoting ancillary units and small scale enterprises in Madras.
- **Punjab National Bank- NAYE:** Entrepreneurship Assistance Programme launched in the States of West Bengal and Bihar in March 1973.
- **Central Bank of India - NAYE:** Entrepreneurship Development Programme being implemented in Maharashtra.
- **Union Bank of India - NAYE:** Entrepreneurship Development Programme inaugurated in June 1975 in Tamil Nadu with an intention to adopt 200 entrepreneurs.

The main objective of the scheme is to help young entrepreneurs in identifying investment and self-employment opportunities; securing proper arrangements for their training including development of their manufacturing capabilities; providing necessary financial assistance on the basis of properly prepared reports; securing package of consultancy services on appropriate terms and arranging for all possible assistance, facilities and incentives being extended to young entrepreneurs by Government and other institutions.

#### 12.3.1 Small Industry Extension Training Institute (SIETI)

SIETI entered the field of consultancy on ad-hoc basis mainly to support the activities of State Governments and development corporations. SIETI's consultancy services have recently become broad-based in terms of both the types of assignments undertaken and area covered. The activities have been operative in Jammu and Kashmir, Karnataka, Nagaland, Meghalaya, Manipur, Assam, Maharashtra and Andhra Pradesh. The assignments in the earlier-years pertained to (1) identification of industrial opportunities, (2) identification of growth centres, (3) preparation of regional development plans, (4) industrial profiles, (5) feasibility studies, (6) organisational development, and (7) designing information system. They now include entrepreneurial development; training and counseling of the educated unemployed; management counseling for sick industrial units; and training of trainers and consultants for entrepreneurial development. Particular attention is given to industrialization of backward areas.

#### 12.3.2 National Productivity Council (NPC)

Recently National Productivity Council has started a Package Consultancy Service to Small Industries. This service is in three stages.



- Training young and prospective entrepreneurs;
- Undertake market surveys in the States. These surveys are conducted for identifying investment opportunities and consumption patterns for the prospective entrepreneurs; develop data bank for providing information in respect of investment opportunities and financial resources required, facilities available for obtaining loans; selection/modernization of processes and equipment, product development, availability of raw materials and market opportunities, sales promotion and marketing and to undertake techno-economic feasibility studies either on behalf of prospective or existing entrepreneurs or on behalf of financial institutions.
- Post-investment service consultancy and follow-up in the following form.

To assist the entrepreneurs in repayment of loans in the minimum possible time by helping them in improving their enterprise level productivity through periodical visits; assist the small scale industries in training of workers in specific trades and supervisory and managerial personnel in techno-managerial subjects, assist the existing enterprises in improving their enterprise level productivity through training and consultancy services; and assisting them in market studies and sales promotion.

### **12.3.3 National Research Development Corporation of India (NRDCI)**

NRDCI makes available processes which have been developed by various laboratories in the country: It brings out periodically a publication, entitled, 'PRDC Processes', which gives in brief particulars of the various processes, uses of the products, raw materials required and capital outlays.. If an entrepreneur is interested to adopt a process, he is expected to pay a lump sum premium; royalty is also payable bi-annually for specified period after starting production. The concerned institute or laboratory releases the process details to the licensee after he has executed an agreement. NRDC also provides technical appraisals on a few projects, which are variously priced at Rs. 25 to Rs. 750 per copy.

### **12.3.4 Khadi and Village Industries Commission (KVIC)**

KVIC was set up in 1953. The primary objective of establishing KVIC is to develop Khadi and Village industries and improving rural employment opportunities. Its wide range of activities include training of artisans, extension of assistance for procurement of raw materials, marketing of finished products and





arrangement for manufacturing and/ distribution of improved tools, equipment and machinery to producers on concessional terms.

KVIC provides assistance to Khadi and Village industries which are characterised by low capital intensity and ideally suited to manufacturing utility goods by using locally available resources. There are about 26 specified-village industries such as processing of cereals and pulses, leather, cottage matches, gur and khandsari, palm gur, non-edible oils and soaps, village pottery, carpentry, gobargas, household aluminium utensils, etc.

KVIC's policies and programmes are executed through 30 State Khadi and Village Industries Boards, 2320 institutions registered under the Societies Registration Act, 1960 and about 30,600 Industrial Cooperative Societies registered under State Cooperative Societies Act. Activities involving pioneering types of work, such as developing new industries in hilly, backward and inaccessible areas are undertaken by KVIC directly.

#### **12.3.5 National Institute of Entrepreneurship and Small Business Development (NISEBUD), New Delhi**

It is an apex national level institute of its kind set up at New Delhi in 1983. Its main functions are to coordinate research and training in entrepreneurship development and to impart specialised training to various categories of entrepreneurs. Besides, it also serves as a forum for interaction and exchange of views between various agencies engaged in activities relating to entrepreneurial development

#### **12.3.6 National Institute of Small Industries Extension Training**

##### **(NISIET), Hyderabad**

This institute was set up in 1956 to develop the required manpower for running small-scale industries in the country. Accordingly, its main functions are:

- To impart training to the persons engaged in small-scale industries.
- To undertake research studies relating to development of small-scale industries.
- To enter into agreements relating to consultancy services both with national and international organisations to provide consultancy services to small industries in the country.



The institute conducts courses in business management for the benefit of the entrepreneurs and semi-managerial personnel of small industries. It is located at Hyderabad.

### **12.3.7 Other Institutes Supporting Entrepreneurs**

Following are some of the important institutes set up by the Government for development of small-scale industries:

- Electronic Training and Service Institute, Nainital.
- Central Machine Tools Limited, Bangalore.
- Sports Goods and Leisure Time Equipment, Meerut.
- Central Institute of Plastics Engineering and Tools, Madras.
- National Institute of Foundry and Forging Technology, Ranchi.

### **12.3.8 Technical Consultancy Organizations (TCOs)**

A network of Technical Consultancy Organisations (TCOs) was established by the all India financial institutions in the seventies and the eighties in collaboration with state level financial/development institutions and commercial banks to cater to the consultancy needs of small industries and new entrepreneurs. At present, there are 17 TCOs operating in various states, some of them covering more than one state. These 17 TCOs are:

- Andhra Pradesh Industrial and Technical Consultancy Organisation Ltd. (APITCO).
- Bihar Industrial and Technical Consultancy Organisation Ltd. (BITCO).
- Gujarat Industrial and Technical Consultancy Organisation Ltd. (GITCO).
- Haryana-Delhi Industrial Consultants Ltd. (HARDICON).
- Himachal Consultancy Organization Ltd. (HIMCO).
- Industrial and Technical Consultancy Organisation of Tamil Nadu Ltd. (ITCOT).
- Jammu and Kashmir Industrial and Technical Consultancy Organisation Ltd. (J&KITCO).
- Karnataka Industrial and Technical Consultancy Organisation Ltd. (KITCO).



- Madhya Pradesh Consultancy Organization Ltd. (MPCON).
- Maharashtra Industrial and Technical Consultancy Organisation. Ltd. (MITCON).
- North-Eastern Industrial Consultants Ltd. (NECON).
- North-Eastern Industrial and Technical Consultancy Organisation Ltd. (NEITCO).
- North-India Technical Consultancy Organization Ltd. (NITCON).
- Orissa Industrial and Technical Consultancy Organisation Ltd. (ORITCON).
- Rajasthan Consultancy Organization Ltd. (RAJCON).
- U.P. Industrial Consultants Ltd. (UPICO).
- West Bengal Consultancy Organization Ltd. (WEBCON).

### Functions

Initially, TCOs' functions were focused on pre-investment studies for small and medium scale enterprises. Over the years, they have diversified their functions to include the following:

- To prepare project profiles and feasibility profiles.
- To undertake industrial potential surveys.
- To identify potential entrepreneurs and provide them with technical and management assistance.
- To undertake market research and surveys for specific products.
- To supervise the project and where necessary, render technical and administrative assistance.
- To undertake export consultancy for export-oriented projects based on modern technology.
- To conduct entrepreneurship development programmes.
- To offer merchant banking services.
- A summary view of the progress/performance of TCOs

### 12.3.9 Commercial Banks and Entrepreneurial Development



In recent times commercial banks have not confined themselves to mere extension of finance to small entrepreneurs but have shown genuine concern for their progress and development. They have now entered the challenging field of promoting new small scale entrepreneurs through entrepreneurship development programmes. In their new role as promoters of small scale sector they have accepted yet another challenging task. They are now holding EDPs in collaboration with specialized institutions such as DIC, SISI, TCOs, etc. with a view to identifying entrepreneurs, especially in backward areas, and training and monitoring them to start new ventures.

### **12.4 Check Your Progress**

1. When was Small Scale Industries Board (SSIB) established?
  - (a) 1955
  - (b) 1954
  - (c) 1953
  - (d) No of the above
2. Why the Small Industries Services Institutes (SISIs) was set up?
  - (a) To serve as interface between Central and State Governments.
  - (b) To render technical support services.
  - (c) To conduct Entrepreneurship Development Programmes.
  - (d) All of the above
3. Which one of the followings is function of The District Industries Centers (DICs)?
  - (a) To conduct industrial potential surveys keeping in view the availability of resources in terms of material and human skill, infrastructure, demand for product, etc.
  - (b) To prepare techno-economic surveys and identify product lines and then to provide investment advice to entrepreneurs.
  - (c) To prepare an action plan to effectively implement the schemes identified.
  - (d) All of the above
4. The term 'industrial estate' is called by .....?
  - (a) Industrial park



- (b) Industrial zone
- (c) Industrial Township
- (d) All of the above

5. Industrial estate were established for.....?

- (a) To provide infrastructure and accommodation facilities to the entrepreneurs.
- (b) To encourage the development of small-scale industries in the country.
- (c) To decentralize industries to the rural and backward areas.
- (d) All of the above

6. Which one of the followings is the objective of National Alliance of Young Entrepreneurs (NAYE)?

- (a) To help young entrepreneurs in identifying investment and self-employment opportunities.
- (b) Securing proper arrangements for their training including development of their manufacturing capabilities.
- (c) Providing necessary financial assistance on the basis of properly prepared reports.
- (d) All of the above

## **12.5 Summary**

SSIs are generally promoted by first generation entrepreneurs. These entrepreneurs lack technical and managerial skills, strong financial background, knowledge about government sponsored infrastructural facilities and subsidies and incentives. They also lack information about existing support systems developed by the Central as well as State Governments. So institutional support is a must to accelerate the growth of entrepreneurship in a country.

A number of institutions are providing institutional support to the entrepreneurs. Government has set up a number of development institutions to support entrepreneurs. Some of the institutions assisting entrepreneurs include District Industries Centers (DICs) and Industrial Estate, Small Industries Development Organization (SIDO), Small Industries Service Institutes (SISI), Small Industry



Development Corporation (SIDCO), Entrepreneurial Guidance Bureau (EGB), National Alliance of Young Entrepreneurs (NAYE), National Productivity Council (NPC) and Venture capital funds (VCF).

In addition, all India financial institutions-IDBI, IFCI, ICICI-have promoted/sponsored a number of Technical Consultancy Organizations (TCOs) to assist small entrepreneurs in different ways. Recently, the Small Industries Development Bank of India (SIDBI) has been established to help small scale units. Besides, agencies like Khadi and Village Industries Commission, Commercial Banks, Cooperative Banks, EXIM Bank and National Science and Technology Entrepreneurship Board undertake promotional activities aiming at support in entrepreneurship development.

## 12.6 Keywords

- **Institutional Support:** It refers to the economic environment of industry and business comprising authorities and institutions whose decisions and operational framework affect the level of business.
- **District Industries Centers:** These provide integrated administrative framework at district level for promotion of SSI in rural areas.
- **Industrial Estate:** It is a planned clustering of industrial units offering standard factory buildings and a variety of services and facilities to entrepreneurs.
- **Commercial Banks:** Institutes that accepts the deposits, offer checking accounts, makes various loans and other services.
- **Government Policy:** Rules and regulation of government regarding production of goods and services in a specific country.
- **Balanced regional development:** Development of all regions equally especially rural and backward areas which are still under-developed.
- **National Alliance of Young Entrepreneurs (NAYE)**-It is a sponsored Entrepreneurial Development Scheme with Bank of India in August 1972 for help young entrepreneurs in identifying investment and self-employment opportunities.
- **National Productivity Council**-It is an institute that provides Package Consultancy Service to Small Industries.



## 12.7 Self-Assessment Test

- Describe the institutional set up for entrepreneurial development in India.
- Discuss the need for institutional support to small-scale industries.
- Discuss the support provided by the National Small Industries Corporation Ltd. (NSIC) to small-scale industries in the country.
- What are the functions performed by the Small Industries Development Corporation (SIDCO) to boost the growth of small-scale industries in the country?
- Describe the role that State Small Industries Development Corporations (SSIDC) play in developing small enterprises in the country.
- What are District Industries Centers (DICs)? Explain the functions of the DICs.

## 12.8 Answers to check your progress

- 1(b), 2 (d), 3(d), 4 (d), 5(d), 6 (d)

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<b>ENTREPRENEURSHIP DEVELOPMENT PROGRAMMES</b>	

## Structure

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### 13.0 Learning Objectives

After reading this lesson, you will be able to:

- Define Entrepreneurial Development and explain the objectives of Entrepreneurial Development Programme.





- Discuss the phases of Entrepreneurial Development Programme.
- List out the organizations providing Entrepreneurial Development Programme.
- Make out the evaluation of EDPs.
- Enlist the problems faced by EDPs.

### **13.1 Introduction**

It is true that a person must have certain entrepreneurial attributes and need not necessarily belong to a particular caste, community or a group to become an entrepreneur. But mere personality traits of an individual would not be sufficient condition for him/her becoming an entrepreneur. Other social, cultural and economic factors as well as support-system also influence, to a considerable extent, the promotion and development of entrepreneurship. However, it has been found that the entrepreneurial attributes of an individual can be improved, to a certain extent, through stimulation and training, provided he or she has latent potential for entrepreneurship. The entrepreneurial potential of an individual thus developed can lead to the promotion of an enterprise with the help of counseling, infrastructural support and financial assistance from institutional sources. And in this way, the constraints in development of entrepreneurship due to unfavorable personality traits, social conditioning, cultural ethos and economic factors, could be reduced to a great extent.

### **13.2 Concept of Entrepreneurial Development**

Development of entrepreneurship incorporates four basic issues viz. (i) the availability of material resources (ii) the selection of real entrepreneurs, (iii) the formation of industrial units, and (iv) policy formulation for the development of the region. All these issues are closely inter-related. Given the resources and the entrepreneurs expected to exploit them, the focal issue that remains is, that of the type of the industrial unit, particularly because it affects the proper utilization of raw material and the marketing of the product. An interaction of the first two variables and the ground work created by the third one depends on the specific policies which constantly supervise the direction of the process of economic development of the region.

Development of an entrepreneur means inculcating entrepreneurial traits into a person, imparting the required knowledge, developing the technical, financial, marketing and managerial skills, and building



the entrepreneurial attitude. The process of entrepreneurial development involves equipping a person with the information used for enterprise building and sharpening his entrepreneurial skills.

Entrepreneurial development is an organised and systematic development. It is now regarded as a tool of industrialization and a solution to unemployment for problem. The objective of entrepreneurial development is to motivate a person for entrepreneurial career and to make him capable of perceiving and exploiting successfully opportunities for enterprises. One trained entrepreneur can guide others on how to start their own enterprise and approach various institutions. In fact trained entrepreneurs become catalysts of developing industry, and economic progress.

Entrepreneurial development programme (EDP) may be defined as “a programme designed to help an individual in strengthening his entrepreneurial motive and in acquiring skills and capabilities necessary for playing his entrepreneurial role effectively”. It is necessary to promote this understanding of motives and their impact on entrepreneurial values and behaviour for this purpose.

An EDP is based on the belief that individuals can be developed, their outlook can be changed and their ideas can be converted into action through an organised and systematic programme. EDP is not merely a training programme. It is process of (a) enhancing the motivation, knowledge and skills of the potential entrepreneurs, (b) arousing and reforming the entrepreneurial behaviour in their day-to-day activities, (c) assisting them develop their own ventures or enterprise as a sequel to entrepreneurial action.

### **13.2.1 Objectives of Entrepreneurial Development Programme**

The urge to achieve is one of the most significant variables associated with economic development. People with high need for achievement tend to be more successful entrepreneurs as compared to people with low achievement. The Kakinada Experiment revealed that entrepreneurship can be developed through training and is not necessarily a hereditary quality. The man behind a project rather than physical and financial facilities is the key to entrepreneurial success. The significance of personality lies in the fact that it is the entrepreneur who has to start and run the enterprise and overcome obstacles in the process of building up and growth of enterprise. The objective of entrepreneurial training is to develop motivation and competence necessary for successful launching, management and growth of the



enterprise. Entrepreneurial development is relatively a recent phenomenon as-compared, to executive development.

The objectives of an entrepreneurial development programme (EDP) may be divided into two categories: short-term objectives, and long-term objectives.

- **Short-term Objectives:** Short-term objectives imply the objectives which are to be achieved immediately after the completion of the programme. Preparing a personality for the entrepreneurial venture, making him competent to scan the environment and situation within the existing regulatory framework are the short term objectives. In brief, short term objective is to help a participant in the fixation of his/her goal of life as entrepreneurisation.
- **Long-term Objective:** In the long run, an entrepreneurial development programme seeks to equip the participants with all the skills required for the establishment and smooth running of business ventures. The ultimate objective is that the participant under training should establish his/her own venture.

Thus, the objectives of an entrepreneurial development programme are as follows:

- To enlarge the supply of entrepreneurs for rapid industrial development;
- To develop small and medium enterprises sector which is necessary for employment generation and wider dispersal of industrial ownership;
- To industrialize rural and backward regions;
- To provide gainful self-employment to educated young men and women;
- To diversify the sources of entrepreneurship, and;
- To improve the performance of small scale industries by developing managerial skills among small entrepreneurs.

### 13.2.2 Phases of Entrepreneurial Development Programme

An entrepreneurial development programme consists of three broad phases:

- Pre-training/ Initial Phase



- Training Phase
- Post-training Phase
- **Initial Phase:** This phase includes the activities and the preparations required to launch the training programme. The main activities of this phase are:
  - Arrangement of Infrastructure for training
  - Preparation of training syllabus and application form
  - Tie up of guest faculty
  - Designing tools and techniques for selecting the trainees
  - Formation of selection committee
  - Publicity campaign for the programme

Thus, initial stage involves the identification and selection of potential entrepreneurs and providing initial motivation to them.

- **Training Phase:** In this phase the training programme is implemented to develop motivation and skills among the participants. The objective of this phase is to bring desirable changes in the behaviour of the trainees. The trainers have to judge how much, and how far the trainees have moved in their entrepreneurial pursuits. A trainer should see the following changes in the behaviour of participants.
  - Is there any change in his entrepreneurial outlook, role and skill?
  - Is he motivated to plunge for entrepreneurial venture and risk that is expected of an entrepreneur?
  - What kind of entrepreneurial behaviour does the trainee lack?
  - Does he possess the knowledge of technology, resources and other related entrepreneurial knowledge?
  - Is he skillful in choosing the right project, mobilizing the right resources at the right time?



- **Post-Training or Follow-up Phase:** Under this phase it is assessed that how far the objectives of the programme have been achieved. Monitoring and follow up reveals drawbacks in the earlier phases and suggests guidelines, for framing the future policy. In this phase infrastructural support, counseling and assistance in establishing new enterprise and in developing the existing units can also be reviewed.

**Selection of Potential Entrepreneurs-**The first step in the EDP is the proper identification and selection of potential entrepreneurs. Selection and training of an unsuitable person to go into independent business is a national waste as well as harmful to the person concerned. His failure in business would result in loss of prestige, or social standing and a setback in life. Therefore, utmost care should be given to their family background, entrepreneurial skills and suitability to the trade chosen. Selection of potential entrepreneurs has two essential components; namely (A) identification of entrepreneurial traits in the potential entrepreneurs, and (B) identification of suitable and viable project for each identified entrepreneur.

❖ **Identifying Entrepreneurial Traits-**Every participant must have a minimum level of eligibility for developing into an entrepreneur. Entrepreneurial traits include socio-personal and human re-sources characteristics. A brief description of these characteristics is given below:

- **Caste and family background:** Caste and family background help create entrepreneurial environment and occupational awareness for the entrepreneurs. There are certain castes which are traditionally involved in certain types of work. Matching of castes with trades, therefore, appears to be logical. Most people prefer to accept familiar tasks easily.
- **Age and Education:** Researches have revealed that younger people are more successful entrepreneurs. This may be because older people are more reluctant to take risky ventures. They are more concerned with avoiding failure than achieving success. A minimum level of education is essential to perform functions like meeting officials, etc.
- **Size and type of family:** The size of the family and the entrepreneur's status in the family are important. A small entrepreneur has generally to depend upon family members as he cannot afford to hire workers. In a large family the entrepreneur may command little authority. But other earning members of the family may enable him to pay undivided attention to his enterprise



by providing financial support to the family. A joint family has generally a greater risk-bearing capacity. But the entrepreneur has greater command over the family resources in a nuclear family.

- **Social participation:** This determines the amount of influence the entrepreneur will be able to muster outside his immediate family circle. Greater social participation improves the ability to influence and thereby the success of the entrepreneur.
  - **Achievement-motivation:** It is the urge to improve one-self in relation to a goal. It includes both personal achievement and social achievement. It is the basis of entrepreneurship as entrepreneurs with high need achievement succeed better.
  - **Risk taking willingness:** It refers to seeking challenge in one's activity. Two persons may view the same venture as involving different degrees of risk. If both of them go for the same venture, it means that the person perceiving greater amount of risk in the venture has the higher risk-taking willingness.
  - **Personal efficacy:** It has been defined as the general sense of adequacy in a person. It is the tendency in an individual to accept success or failures which are within his control. Personal efficacy is an important factor contributing to entrepreneurial behaviour of person. It represents the potential effectiveness present at the inner level.
- ❖ **Identification of Enterprise-**Once an entrepreneur having necessary socio-personal and human resource characteristics is identified, it is necessary to identify a suitable enterprise or project for him. The enterprise must be matched with the potential entrepreneur. All the background information like his skills, experience in the field, the physical resources available, family occupation, etc. should be taken into consideration. Having found a suitable trade an entrepreneur needs to thoroughly examine its viability in terms of financial implications. The raw materials availability, the marketing avenues and profitability of the enterprise have to be explored. It would also involve detailed 'exploration of services needed and available in the area.

### Contents of Training Programme



- **Technical Knowledge and Skills:** The entrepreneur has to be well- conversant with the process of manufacture and trading for which a practical training based on sound theory is essential. He needs to know the economic aspects of the technology including costs and benefits. Field trips to a few industrial units and in plant training can be very helpful.
- **Achievement Motivation Training (AMT):** The purpose of AMT is to develop the need to achieve, risk taking, initiative and other such behavioral or psychological traits. A motivation development programme creates self-awareness and self-confidence among the participants and enables them to think positively and realistically. Without achievement motivation training, an EDP becomes an ordinary executive development programme.
- Motivation training initiates people to business activity or helps them to expand their business ventures. They learn to strive for excellence, to take calculated risk, to use feedback for improvement, sense of efficacy, etc.
- Traditionally, laboratories for entrepreneurial motivations were conducted to stimulate people's interest in setting up their own enterprises and to groom them into enterprise builders. These laboratories also aim at developing inclinations which ensure continuous self-appraisal and organisational revival.
- **Support Systems and Procedures:** Training needs to include information about support systems. The participants have to be exposed to agencies like the local banks and other financial institutions, industrial services corporations and other institutions dealing with supply of raw materials, equipment, etc. The session on support systems needs to also include the procedures for approaching them, applying and obtaining assistance from them and availing of the services provided by them. A linkage between the training institute and the support system agencies can be established by participation of these agencies in sponsoring and financing the EDP.
- **Market Survey:** The participants should be given opportunity to actually conduct market surveys for their chosen projects. This would help expose the candidate to the marketing avenues available and could be followed by sessions on methods of dealing in the markets.
- **Managerial Skill:** Once a participant is able to start the enterprise, he requires managerial skills. A list of the agencies along with details of the formalities to be completed, specimen forms to be filled



in would greatly facilitate the entrepreneurs. It should include all aspects of financial management. Managerial skills are particularly essential for a small scale entrepreneur who cannot afford to employ specialists in different areas of management. The aim should be to enable the participant to look at an enterprise in its totality and to develop overall managerial understanding.

- **Project Preparation:** A lot of time needs to be devoted to the actual preparation of projects. Their active involvement in this task would provide them necessary, understanding and also ensure their personal commitment. During the course of training various guidance sessions are helpful for enabling the trainees to identify appropriate business opportunities. Information and counseling on various feasible business opportunities is provided through the team of experts and by spot surveys. Necessary experience is provided in market surveys, project preparation, sources of finance, etc. Undue emphasis on any dimension in entrepreneurial development should be avoided as it may lead to distortion in both process and content of the programme.

### Support Systems

After equipping himself with the requisite skills, the new entrepreneur is now ready to set up his enterprise. In order to launch his new venture, he requires assistance and support of many agencies. These are the support systems which form a large and an important part of the EDP. The strength and coordination of the support system form the backbone of an EDP. Credit, service and implementing institutions form the three major support systems.

In order to accelerate growth of entrepreneurship, it is absolutely necessary to develop various support systems at least in the initial stages of growth. Such support systems have to function till such time a critical number of entrepreneurs are developed in the society, so that entrepreneurship does not remain an isolated, individual-dominated phenomenon. Only systematic and organised nurturing of entrepreneurship would ultimately generate pressures in the existing socio-economic and political institutions, cultural attitudes, practices and values towards modernization.

McClelland contends that increasing opportunity improves business performance regardless of motivation levels, provided the government can raise probability of success in business from low to moderate by various aids and guarantees. It will also succeed in getting more people into business activity regardless of initial level of need for achievement in the population. Thus, one method of





increasing opportunity and ensuring entrepreneurial success is by providing a network of support systems under entrepreneurial development programme.

It would be of little use to anyone if these support systems exist as separate, independent entities. They need to coordinate and complement one another. The coordinating agency must ensure that these institutions such as credit, marketing services and information systems are involved in the EDP right from the selection, all through.

**Production:** Once production starts the entrepreneur has to initiate supply of products through suitable marketing channel. Thus, production and marketing are the most crucial stages in an entrepreneurial endeavor. Failure in either would mean a breakdown in EDP. The EDP consists of five distinct stages- selection, training, support systems, production and monitoring. It is a dynamic interrelationship between these components.

**Monitoring and Follow Up-**For the success of any entrepreneurial development continuous monitoring and follow up is essential. It is only through proper monitoring that defects and problem can be identified and removed. Care is required so that the monitoring procedure is not too bureaucratic where rules become inhibitive rather than promotive. Monitoring should provide continuous guidance to ensure better results.

Monitoring and follow-up should be conducted during each stage pertaining and post-training of the EDP. Pre-training follow up involves evaluation of training infrastructure and training syllabus. Post-training phase is designed to help entrepreneurs achieve technical, managerial, marketing and financial skills. Different types of follow-up strategies may be required for motivated, semi-motivated and unmotivated entrepreneurs. It is necessary to sustain the motivation of the first type and to improve the motivation in the second case through counseling, etc.

### **The Target Group**

The EDPs may be organised for anyone of the following target groups:

- **Technical and other Qualified Persons:** This group consists of persons who have pursued technical and allied courses of study. For instance, degree/diploma holders in science, engineering and technology are an important group in India. The government and Semi-Government



agencies/institutions operate special entrepreneurial development programmes and schemes of assistance for this group. The training programme for such people may be designed to enable and assist them in setting up their own manufacturing units. The industries selected for this purpose may be directly related with their qualifications and experience. For example, graduates in electronics may be trained to establish and operate successfully plants for manufacturing TV sets, videos, and other electronic items.

- **Ex-Servicemen:** Persons who have retired from the army, navy and air-force constitute an important group for entrepreneurial training. These persons have acquired many useful skills and experience during their service period. They tend to be highly disciplined, hardworking, enterprising and innovative. Therefore they can become successful entrepreneurs after proper entrepreneurial training. The Government of India provides special facilities and preference in order to rehabilitate them. Many ex-servicemen are successfully operating their own manufacturing, training and service enterprises in the country.
- **Business Executives:** Some business executives want to start their own independent enterprises after getting sufficient business experience. Some of them have certain innovative ideas which they are not able to try in their existing firms due to lack of sufficient autonomy or authority. Some among them are not satisfied with their present economic and social status. After entrepreneurial training senior business executives can become successful entrepreneurs. They already possess knowledge of management. What they need is training and support for launching their own enterprises.
- **Women Entrepreneurs:** Women are entering the world of business in increasing numbers, especially traditional food processing industries like spices, agarbati, papad, sauces, etc? Several government and non government organisations e.g. FICCI Ladies Organisation, etc. are therefore, organising entrepreneurial training programmes for women.
- **SC and ST Entrepreneurs:** Government of India is committed to the upliftment of scheduled castes (S.C.) and scheduled Tribes (S.T.). Therefore, specified percentages of jobs have been reserved for these castes. But all persons from these groups cannot be offered employment. Therefore, providing self-employment is useful for their economic and social development.



Government agencies give preference to S.C. and S.T. entrepreneurs in providing finance and other necessary facilities.

- **Special Agencies and Schemes:** The Government of India has established specialised agencies for training entrepreneurs. Special schemes have also been launched to train, develop and assist entrepreneurs. Some of the special agencies and schemes for entrepreneurial development are given below. These programmes should be conducted in places where necessary infrastructure for training is available and proximity of the support agencies is assured. This would underline the need for proper selection of the trainees. It should be ensured that the trainees show interest in setting up industries. For this purpose, we should think new techniques to make the process of selection more appropriate. Poor involvement on the part of the institutions as also trainees and an incorrect selection of target groups contribute largely to the failure of a number of EDPs. One of the objects of training should be on changing the attitude and set of mind of young people from security-oriented activities to risk-taking through entrepreneurship development.

### 13.3 Entrepreneurship Development Programme Organizations

There are several organizations engaged in conducting entrepreneurship development programmes in India. The lead in the matter was given by Small Industries Development Organisation through its Small Industries Service Centres.

In the area of creating the institutional infrastructure for entrepreneurship development, the first step of India financial institutions including IFCI was the establishment of Entrepreneurship Development Institute of India (EDII) in March, 1983, at Ahmedabad as a resource organisation at the national level. The Central Government also established in the same year the National Institute for Entrepreneurship and Small Business Development (NIESBUD) at New Delhi, with the objective of coordinating activities related to entrepreneurship and small business development. Both these organisations are working hand in hand for giving a fillip to the entrepreneurship development movement.

In addition, institutions established by the government are: Rural Entrepreneurship Development Institute (RED) at Ranchi in 1983, Rural Management and Management centres (RMEDC) at Maharashtra and Training cum Development centres (RDCS) aim increasing interaction between entrepreneurs and enterprise.



This apart, a host of management institutions various universities have included entrepreneurship development in their Curriculum.

Other organisations that have-been actively conducting entrepreneurship development programmes are State Bank of India; financial institutions such as IDBI; Entrepreneurial Motivation Training Centre in Northern-Eastern Region; Xavier Centre for Entrepreneurship Development, Ahmedabad; state financial corporation's; the Centre for entrepreneurship Development, Hubli; Small Industries Extension Training Institute, Hyderabad; National Science and Technology Entrepreneurship Development Board etc.

For institutionalizing the entrepreneurship development activities at the state level, Institutes of Entrepreneurship Development (IEDs) in Uttar Pradesh, Bihar and Orissa have already come into existence with the support of India's financial institutions, concerned State Governments and banks, and are carrying on their activities on a full-fledged basis. During the period under review, a Centre for Entrepreneurship Development (CED) was registered in Madhya Pradesh on 17th November, 1988, taken up later by IFCI. An Institute for Entrepreneurship Development was also set up at Goa on the same pattern as other IEDs. A few State Governments of Karnataka, Andhra Pradesh, Rajasthan, etc., have also expressed the desire to set up CEDs in their respective States. The proposals of these State Governments to be considered on their merits by the financial institutions in due course, while the focus of the national organisations like EDII, NIESBUD etc., continued to be on (a) institutional entrepreneurship activities, (b) generating, sharpening and sharing knowledge through research documentation and publication, (c) creating and developing professionals in the discipline of "entrepreneurship" to emerge and flourish, and (e) developing new products and pursuing market segments for carrying the entrepreneurship development in priority areas and sections of the people. The State level Institutes/CEDs endeavored to carry out at the grass-root level to provide the support of human resources to various State and district EDPs level organisations engaged in entrepreneurship. The State-level organisations also continued to provide industrial extension motivation services, business opportunities guidance, project counseling, etc., and helped in initiating entrepreneurship at school level in the career planning of the younger generation. For this these organisations conducted, during the period under review, a number of workshops, seminars, conferences and brought out well researched publications, for training of entrepreneurs. The organisations also produced a number of



video films as audio-visual aids for training the entrepreneurs and motivating them towards enterprise setting and operating the same on sound and healthier lines.

**Management Development Institute (MDI)**-For developing and improving the quality of day-to-day management, which is so crucial for the success of any industrial venture, as also, with a view to encouraging professionalization in management, IFCI had sponsored in 1973, the Management Development Institute (MDI) at Gurgaon. MDI is now a reputed centre of management training, research and consultancy. Its prime goal is to improve managerial effectiveness in the industry/government and banking sectors of the economy. Research studies undertaken by MDI are in both macro areas of economic and industrial development as also in micro areas relevant to a specific industry or economic activity.

A mention was made in the last year's Annual Report about MDI having been chosen by the Government of India, Department of Personnel and Training as an agency for conducting the first-ever intensive 15 month National Management Programme (NMP) for Government Officers belonging to IAS/Group 'A' Services as well as executives from public and private sector organisations having potential to acquire top positions.

MDI conduct Management Development Programmes in various disciplines. These programmes included the programmes for officers of the Indian Economic Service (IES), Indian Administrative Services (IAS) and for the executives of a number of PSUs of, like 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 and Pharmaceuticals Ltd., (IDPL), Uttar Pradesh, State Industrial Development Corporation Ltd. (UPSIDC), Madhya Pradesh Financial Corporation (MPFC), etc.

MDI also had conducted in Karnataka a programme on Identification, Promotion and Implementation of Industrial Projects' (IPIIP) specially catering to the needs of officers of District Industries Centres (DICs), State level Promotional and Financial Institutions, Commercial Banks, etc. In addition, a number of programmes, particularly in concerning strategic planning, marketing of new products, strengthening of cooperative short term credit system, marketing and sales, management consultancy,



development banking; labour-management relations, human resources development, evaluation of small industries financing performance, role of directors, merchant banking, leasing, working capital financing, technology transfer, management, documentation and recovery practices of Development Financing Institutions, etc., were carried out by MDI and its subsidiary Development Banking Centre (DBC). As many as 23 workshops were conducted by MDI under the Planning Commission International Labour Organisation United Nations Development Programme, In-house Management Consultancy Development Project (Phase II).

**The National Institute for Entrepreneurship and Small Business Development (NIESBUD)**-The 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, registered as a Society under Government of India Societies Act XXI of 1860, started functioning from 6 July, 1983.

Over the years, the Institute stands devoted to evolving model syllabi for training various target groups- by effective training strategies, methodology, manuals and tools; facilitating and supporting Central/State governments and other agencies in benefit and accelerating entrepreneurship development; conducting programmes for motivators, trainers and entrepreneurs which are commonly not undertaken by other agencies. Above all organising those that help in developing entrepreneurial culture is worth appreciation in society. 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 Institute, therefore, performs the task of processing the recommendations made by the Board.

### **Objectives**

The main objectives of the NIESBUD are:

- To accelerate the process of entrepreneurship development ensuring its impact throughout the country and among all segments of the society.
- To help/support institutions/agencies in carrying out activities relating to entrepreneurship development with greater success.



- To evolve standardized process of selection, training support and, sustenance to potential entrepreneurs enabling them to set up and run their enterprise successfully.
- To provide vital information support to trainers, promoters and entrepreneurs by organising documentation and research work relevant to entrepreneurship development.
- To provide functional forums for interaction and exchange of experiences helpful for Policy formulation and modification at various levels.

### **Activities**

The activities of the Institute 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.

The various functions which the National Institute has been called upon to perform are as follows:

- To organize and conduct training programmes;
- To co-ordinate the training activities of various institutes and organisations in the country imparting training in entrepreneurship;
- To affiliate institutes and organisations conducting entrepreneurship training;
- To identify, train and assist potential entrepreneurs amongst technical and non-technical personnel in setting up self-employment ventures in small industries including service industries;
- To hold examinations and tests and confer certificates and diplomas on the trainers as well as trainees;
- To undertake documentation and research in the field of entrepreneurship and small business development;
- To conduct workshops, seminars and conferences etc. for promotion and development of entrepreneurship in small scale industries and small business;



- To publish literature for furtherance of entrepreneurship and small business development;
- To provide a forum for interaction and exchange of view with agencies engaged in various aspects of entrepreneurship in small industries and small business development.
- To assist in setting up of regional and state level training institutes for entrepreneurship and small business development.

The Institute interacts with all other organisation centres engaged in conducting entrepreneurship development programmes in the country and provides them support in various areas including funding of programmes wherever necessary and feasible. The Institute addresses itself to working with them in enhancing the efficiency and utility of entrepreneurship development programmes bringing about co-ordination.

With the setting up of this institute, entrepreneurship development in India through organised training has assumed added significance particularly for training educated unemployed youth for taking up self-employment ventures.

**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 attention on developing programmes 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. EDII over the years has carried out experiments in rural entrepreneurship development in a cluster of village of U.P. and Orissa in collaboration with a voluntary organization. EDII prepared a video cassette on the focused behaviour event interview technique for assessing entrepreneurial potential. In addition, it conducted an entrepreneurs' meet, entrepreneurship development orientation programmes and training programme for trainers, besides giving professional assistance to various institutions for their entrepreneurial development activities. EDII continued to offer its service to Sri Lanka, Nepal, Kenya, Ghana and other African Commonwealth Countries. The institute has organised a special camp on entrepreneurship in which more than 2,000 students had participated in various activities creating interest in entrepreneurial





pursuits. In the Nehru Centenary Year, EDII brought out a book entitled “Self-made Impact making Entrepreneurs” based on a study undertaken by it.

**Institutes for Entrepreneurship Development**-As part of a strategy of giving special attention to entrepreneurship development needs of the more backward states, IDBI had announced the proposal to set up Institutes for Entrepreneurship Development (IEDs) in association with other financial institutions and banks and the State Governments. IEDs set up in Uttar Pradesh, Bihar and Orissa have become operational and the proposed IED in Madhya Pradesh has already been registered.

IED in the UP had conducted more than 16 EDPs, besides training state level trainers. It also has conducted programmes on industrial extension motivation, business opportunity guidance and project counseling for women, entrepreneurial awareness workshop for ex-serviceman, state level meet of EDP conducting agencies, studies on “Factors inhibiting and facilitating turnaround possibilities in small sector” and “Relevance of hill wool scheme.” IED in Orissa had conducted II EDPs which benefited 307 trainees. It also conducted four Management Development Programmes, four entrepreneurship awareness camps and lecture-cum-discussion session on “Problems and Prospects of Indo-US Trade and Investment. “IED in Bihar conducted two EDPs and organised an entrepreneurs’ meet during the period under review.

**Science and Technology Entrepreneurship Parks (STEPs)**-As part of the programme for supporting the setting up of 15 STEP s jointly with other institutions, IDBI over the years has assisted seven STEP s, viz, those sponsored by the Birla Institute of Technology (BIT), Ranchi, National Entrepreneurs Chemical Park (NECP), Regional Engineering College Trichy, (TREC), 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 Rs. 6.2 crore. While the first five STEP s were sanctioned assistance prior or 1988-89, the last two were sanctioned assistance during the reporting period. STEP s proposed by Guru Nanak Engineering College will specialize in machine- tools and electromechanical control equipment while the STEP sponsored by the Maulana Azad College of Technology will be specializing in electronics and power engineering.



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 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. Commercial production had already been started by seven TREC-STEP entrepreneurs. Student entrepreneurs of HBTI-STEP are working on projects which include fiber reinforced concrete and plastic components. SJCE-STEP has already transferred technology of liquid level pump controller to one of its entrepreneurs for commercial exploitation and eight of the STEP entrepreneurs have established their units.

**The Entrepreneurial Motivation Centre**, set up in Assam in the north eastern region of India, conducts entrepreneurial development programmes. In the earlier stages, 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. in 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. Selection was made based on psychological tests and personal interviews. Selected entrepreneurs were given preliminary motivation training of two weeks for developing or strengthening the motivation for self-employment, managerial and economic aspects of entrepreneurial development. The entrepreneurs were further assisted in selecting enterprises for themselves, conducting market surveys and preparing economically viable and feasible project reports. The Centre acted as link agency and helped the entrepreneurs in obtaining finance from banks and other institutions, and readymade sheds as working space. The Centre further provided 10 per cent of the sanctioned amount as seed money wherever necessary. An evaluation revealed that by March 1975, the number of entrepreneurs trained came to 1,550, of which 1,053 entrepreneurs (68 per cent) completed their project reports and 581 were given in-plant training. Among those who completed the project reports, 310 entrepreneurs were assisted in obtaining sanction of financial assistance. Of these 310 entrepreneurs, 279 (90 per cent) actually established their enterprises and started functioning.



**The Xavier Institute of Social Service in Ranchi:** It was involved with tribal and people from the villages in training to become entrepreneurs. A group of young tribal youths constituted into a local organisation for promotion of socio-economic and health schemes (known as Vikas Maitry) received some funds from the Indo-German Social Service Society in New Delhi in 1975. They desired that an entrepreneurship development programme be run for them. A project leader who himself was a tribal was appointed: The programme was organised and 20 candidates were selected, all belonging to tribal areas. In selecting, little importance was given to academic qualifications. Clarity of presentation of goals and determination to reach that goal were the important considerations. Four months full-time training was arranged. During the day the entrepreneurs worked as apprentices in shops of the type they intended to set up themselves. In the evening, they got grounding in the basis of achievements, motivation, leadership and communication, management, finances, costing, laws and taxation, marketing and project preparation. After completion of the training course, the entrepreneurs went back to their respective villages and made mini-market survey. They brought back the field data and worked these into a project proposal for financing by the bank. The financing was undertaken through the intermediacy of Vikas Mantri Kalyan Sangh and the organisation undertook to stand guarantee for the young entrepreneurs. Continuous and sustained follow-up action was undertaken. This was the responsibility of the project officer and assistant project officer. A success rate of 60 per cent was attained. The State government later gave assistance to the institute for conducting entrepreneurial development programmes for unemployed engineers, diploma holders, graduates and ITI trained boys and the institute has done well.

**Development Banks:** These institutions provide vital inputs like finance and development assistance. IFCI, ICICI, and IDBI are operating at the all India level whereas SFCs and SIDCs are functioning at the State level. IFCI, ICICI and IDBI take special interest in promoting entrepreneurship, particularly in backward areas and rural centres through assistance to various institutions, conducting EDPI and by providing financial assistance to new entrepreneurs. These institutions also provide active support to other institutions like TCOs, National Science and Technology Entrepreneurship Development Board of India (NSTEDB), Entrepreneurship Development Institute of India (EDII) and other agencies. In order to encourage rural and tiny enterprise IDBI provides financial support to selected voluntary agencies. Another important step taken by IDBI to encourage entrepreneurship among science and technology



graduates is through Science and Technology Entrepreneurship Parks' (STEPs). IDBI also operates Seed Capital Scheme for technically qualified entrepreneurs in small scale sector to meet a part of promoter's equity capital. Special concessions are given to women, SC/ST and physically handicapped entrepreneurs. IFCI provides risk capital assistance to new entrepreneurs through the Risk Capital Foundation (RCF). In 1955 NSIC was set up to promote the growth of small scale industries.

In addition to the above, State level financial institutions (SFCs) and developmental institutions (SIDCs) render financial assistance to new entrepreneurs in the respective State. Some State governments have also set up State Small Industries Corporations to promote small scale entrepreneurs. Many states have setup Entrepreneurs Guidance Bureaus, consultancy organisations, Stores Purchase Organisations, State small industries corporations and such other bodies to assist entrepreneurs in their respective areas.

**Commercial Banks**-Initially, The State Bank of India was the only bank amongst commercial banks to come out with a comprehensive programme for entrepreneurship development. From the orthodox role of commercial banks, the State Bank of India pioneered as a premier banking institution in India by assuming the role of a development bank. The sixties and early seventies saw many important strides towards the fulfillment of this objective. The bank recognized the importance of small-scale industries in industrial development and started financing small-scale industries on a large scale. To cater to the specific needs of this sector a package of schemes and programmes was formulated by the bank. These are in (i) Liberalized scheme of financing small-scale industries wherein 75 per cent of the project cost is met as bank loan; (ii) Entrepreneur scheme for financing technically-qualified persons where the entire project cost could be financed by way of term loan; and (iii) Equity Fund Scheme for providing interest-free loan to meet the equity gap up to Rs. 1 lakh.

**Non-financial Support**-In spite of liberalisation in financing policy and government incentives; the progress industrialization was not so rapid. Realizing that mere provision of financial support was not sufficient for bringing about that desired change, the need was felt for evolving a policy of providing for non-financial assistance. A number of measures were thereafter initiated-development of management skills of the SSI borrowers through Management Development Programmes and Management Appreciation Programmes. The bank went to the extent of conducting training programmes for



development of entrepreneurial attitude-and financing such entrepreneurs. It was indeed the beginning of a new banking era.

To set up an industry, the ability to meet the margin money requirements of the small-scale project itself is not enough, but entrepreneurial characteristics have to be identified and reinforced in the entrepreneur of that industry. Thus the important characteristics of the entrepreneur, namely, psychological, economic, social and managerial characteristics, have to be learnt, understood and digested by every prospective entrepreneur. For the success of the industry, the man behind the project is more important than its fixed assets; the entrepreneur has to be trained well. Industrial and Technical Consultancy Organisation Limited (ITCO), as subsidiary of Industrial Development Bank of India, having a professional experience in counseling the entrepreneurs, identifying the project ideas and preparing detailed project reports and conducting EDPs.

These programmes cover all educated unemployed youths-

- Having a strong desire to set up an industry and having the confidence of its success.
- With basic technical qualification of SSC with 5 years industrial experience.
- In the age group of 21 to 35 years.
- Able to invest the required share capital (25 per cent of project cost) to the selected project.
- With independent thinking and decision-making status.
- Claiming nativity of the district.

This course is intended to give a working knowledge of industrial promotional agencies, project report preparation, general management of small-scale industries, besides transforming the prospective entrepreneurs by achievement motivation. These programmes include the academic inputs necessary for the purpose.

### **13.3.1 Evaluation of EDPs**

Developing entrepreneurship has become a movement in India in the recent years. EDPs have been considered as an effective instrument for developing entrepreneurship in the countryside. Hundreds of EDPs are conducted by some 686 organisations to impart entrepreneurial training to participants in



thousands. As mentioned earlier, the main objective of EDPs is held to be enterprises creator. Hence, it seems necessary to see whether the objective of EDPs is fulfilled or not. In simple words, there is a need to have a retrospective look into how many participants have actually started their own enterprises after completing the training. This calls for evaluation of EDPs. So far some 16 evaluation studies have been conducted by various organisations and individual researchers. No doubt, these studies vary in their objectives, coverage and content. But, one common thread in all of them is the assessment of effectiveness or impact of EDPs, howsoever, loosely, defined. One of the earliest attempts in this direction was made by a team of researchers and experts appointed by the Gujarat Corporations to evaluate the effectiveness of EDPs. The most recent and nationwide evaluation study on EDPs is on carried out by the Entrepreneurship Development Institute of India, Ahmedabad. Here, we are presenting the bird's eye view on the findings of this study.

#### Performance of the Sample EDPs at a Glance

Sr. No.	Description No.	Number of total	Percentage
A	Sample of Study		
1	EDPs Covered (Sample Size)	145	25
2	EDP Trainees Covered in Sample EDPs	1295	30
3	Sample Trainees Interviewed	865	66.80
4	Sample Trainees Not Available and Non-Traceable	430	33.20
B	Macro Performance of EDPs		
1	Number of Units set-up by the EDP Trainees	277	21.39
2	Trainees Actively Under Process	78	6.02
3	Potential Start-ups (1+2)	355	27.41
4	Trainees Blocked Under Process	129	9.96
5	Trainees who gave up	381	29.93



6	Non-traceable Trainees	146	11.27
7	Trainees Not Available for	284	21.93
8	Actual Start-up Rate (1 +7.1)	336	25.95
9	Expected Final Start-up Rate (2+8)	414	31.97

It is observed that one out of every four trainees (26 per cent) actually started his/her enterprise after undergoing entrepreneurial training. However, the expected final start-up rate is slightly 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 not helped effectively, they may join the category of those 29 per cent trainees who have already given up the idea of launching their ventures. Out of 430 trainees who could not be contacted personally during the field survey, according to the secondary sources, viz., family, friends and neighbours, 17 per cent have given up the idea of venture launching as they are engaged in other activities.

However, the performance of EDPs across the states and across the ED organisations has not been uniform. The actual start-up rates are observed to be oscillating between 9 per cent and 56 per cent, bringing down the overall national start-up rate to about 26 per cent which cannot be considered as impressive performance. And in this non-impressive performance lies the need for looking at the problems and constraints of EDPs.

### 13.3.2 Problems Faced by EDPs

EDPs suffer on many counts. The problems and lacunae are on the part of all those who are involved in the process, be it the trainers and the trainees, the ED organisations, the supporting organisations and the state governments. The important problems EDPs face are listed as follows:

- Trainer-motivations are, not found up to the mark in motivating the trainees to start their own enterprises.
- ED organizations lack in commitment and sincerity in conducting the EDPs. In some cases, EDPs are used as a means to generate surplus (income) for the ED organisations.
- Non-conducive environment and constraints make the trainer motivator's role ineffective.



- The antithetic attitude of the supporting agencies like banks and financial institutions serves as stumbling block in the success of EDPs.
- Selection of wrong trainees also leads to low success rate of EDPs.

Thus, it is clear that the problems are not with the strategy but with its implementation. One way of evaluating the EDPs is to assess their effectiveness in developing 'need for achievement' among the entrepreneurs. This is also called 'the qualitative evaluation' of EDPs.

### 13.4 Check Your Progress

1. Development of entrepreneurship incorporates which one of the following issue?
  - (a) the availability of material resources
  - (b) the selection of real entrepreneurs
  - (c) the formation of industrial units
  - (d) All of the above
2. Which one of the followings is the result of Kakinada Experiment?
  - (a) Entrepreneurship can be developed through training
  - (b) Entrepreneurship cannot be developed through training.
  - (c) Entrepreneurship is hereditary quality
  - (d) None of the above
3. Which one of the followings is the objective of an entrepreneurial development programme?
  - (a) to enlarge the supply of entrepreneurs for rapid industrial development
  - (b) to develop small and medium enterprises sector
  - (c) to industrialize rural and backward regions
  - (d) to provide gainful self-employment to educated young men and women
  - (e) All of the above
4. Which one of the followings is activity includes in pre-training phase?
  - (a) Arrangement of Infrastructure and guest faculty for training
  - (b) Preparation of training syllabus and application form





- (c) Designing tools and techniques for selecting the trainees
- (d) Formation of selection committee and Publicity campaign for the programme
- (e) All of the above

5. Contents of a training programme should include.....?

- (a) Technical Knowledge and Skills
- (b) Achievement Motivation Training
- (c) Support Systems and Procedures
- (d) All of the above

6. Which one of the followings is the Entrepreneurship Development Programme Organizations in India?

- (a) Management Development Institute (MDI)
- (b) The National Institute for Entrepreneurship and Small Business Development (NIESBUD)
- (c) Both a & b
- (d) None of the above

### **13.5 Summary**

Entrepreneurship is one of the inputs in the economic development of a country. Entrepreneurs are not just born they can be developed and trained. Entrepreneurial development is an organized and systematic development. It is now regarded as a tool of industrialization and a solution to unemployment for problem. The process of entrepreneurial development incorporates equipping a prospective entrepreneur with institutional support system and backup used for enterprise development and sharpening his entrepreneurial competencies. EDP is designed to identify persons with entrepreneurial abilities and to train them to set up new enterprise.

An EDP consists of three broad phases namely pre-training phase, training phase and post-training phase. A successful training programme must include Technical Knowledge and Skills, Achievement Motivation Training, Support Systems and Procedures etc. There are many organizations in India which



are engaged in conducting entrepreneurship development programmes. The first step of India financial institutions including IFCI was the establishment of Entrepreneurship Development Institute of India (EDII) in March, 1983, at Ahmedabad as a resource organization at the national level. The Central Government also established in the same year the National Institute for Entrepreneurship and Small Business Development (NIESBUD) at New Delhi. Rural Entrepreneurship Development Institute (RED) at Ranchi in 1983, Rural Management and Management centers (RMEDC) at Maharashtra and Training cum Development centers (RDCS) aim increasing interaction between entrepreneurs and enterprise. This apart, a host of management institutions various universities have included entrepreneurship development in their Curriculum.

Other organizations that have-been actively conducting entrepreneurship development programmes are State Bank of India; financial institutions such as IDBI; Entrepreneurial Motivation Training Centre in Northern-Eastern Region; Xavier Centre for Entrepreneurship Development, Ahmedabad; state financial corporation's; the Centre for entrepreneurship Development, Hubli; Small Industries Extension Training Institute, Hyderabad; National Science and Technology Entrepreneurship Development Board etc.

### 13.6 Keywords

- **Entrepreneurial Development Programme:** A programme designed to help a person in strengthening and fulfilling his entrepreneurial motive and in acquiring skills and capabilities necessary for playing his entrepreneurial role effectively.
- **Economic Growth:** Economic growth is an increase in the production of economic goods and services, compared from one period of time to another.
- **Industrialization:** The development of industries in a country or region on a wide scale.
- **Pre-training/ Initial Phase:** Pre-training phase refers to the activities and preparatory work made before the actual conduct of training
- **Training Phase:** Training phase refers to the activities and preparatory work made during the actual conduct of training.



- **Post-training Phase:** Post-training phase refers to the activities and evaluation made after the conduct of training.
- **Skills:** A skill is the ability to perform an action with determined results often within a given amount of time, energy, or both.
- **Achievement Motivation Training (AMT):** The purpose of this is to develop the need to achieve, risk taking, initiative and other such behavioral or psychological traits.
- **Development Banks:** Institutions providing vital inputs like finance and development assistance.
- **Commercial Banks:** Commercial banks make money by providing and earning interest from loans such as mortgages, auto loans, business loans, and personal loans.

### 13.7 Self-Assessment Test

- Discuss the concept, objectives and stages of Entrepreneurship Development Programmes (EDPs).
- List out the entrepreneurship development programmes available in India. Describe any two programmes in detail.
- Give an overview of the progress of entrepreneurship development program in India.
- Write a detailed note on the followings:
  - Entrepreneurship Development Programme Organizations
  - Evaluation of EDPs
  - Problems faced by EDPs

### 13.8 Answers to check your progress

- 1(d), 2 (a), 3(e), 4 (d), 5(d), 6 (c)

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