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**Chapter 1: Who is an entrepreneur and charms of being an entrepreneur?**

An individual, while making a career choice, has three options: to work for someone, be self-employed in a profession or become an entrepreneur.

*Let us take the first option*

It is fine to work for someone, provided you can land a good job, and secondly if you do not mind taking orders from someone else. In these days of unemployment it is not easy to get jobs ‑ especially good jobs, if you do not have specialized academic qualifications. And even if you do get a job, do you have any scope for doing as you wish, how you wish?

*Who is an entrepreneur?*

An entrepreneur can be defined as one who initiates and establishes an economic activity. As an entrepreneur, you work for yourself, establish yourself and set high targets or goals and achieve them. In entrepreneurship, the individual is the most important element. It is he/she who takes the decision to start an enterprise, and who strives to make it a success. Three main factors influence his/her behaviour: knowledge, skill and motivation. Entrepreneurship is not limited to any class, community or religion. There is no age bar, for any person who possesses certain behavioural traits and attitudes, can be developed to become an entrepreneur.

***The charms of being an entrepreneur are many*:**

* An entrepreneur is an independent being, entrepreneurship provides an opportunity for self-expression and realization of one's passion for doing something new and different ‑ a scope for innovation.
* An entrepreneur with better educational background can introduce modern technology, develop substitutes for imported components.
* Opportunities for self-development are many.
* Monetary rewards can be more than commensurate with one's capacity and capabilities.
* Working on one's own and getting rewards for that gives immense satisfaction and pleasure than what he/she gets in his/her job.
* An entrepreneur can make significant contribution to the development of the country.
* An entrepreneur makes his/her own decisions and acts on them.
* An entrepreneur generates employment for others.
* Above all he/she can be an achiever, realize his/her goal and prove one's achievements to the world.
* An entrepreneur achieves double fulfillment. He/she realizes the goals, individual status as well as contribution to the society, to benefit from one's own competence and experience.

**Who is an entrepreneur and what is his/her Role?**

An entrepreneur is a person who takes the risk of setting up his/her own venture for perceived rewards. He/she initiates the idea, formulates a plan, organizes resources and puts the plan into action to achieve his/her goal. Entrepreneurs have specific qualities; they have special strengths, which they draw upon for their adventure into business. If you want to start and succeed in your enterprise, you are required to play different roles at different stages of your enterprise.

**Rewards**

But the path is not strewn with roses, there are hard work, difficulties and problems and then though you may be your own master, you are dependent not merely on the financial institutions but even your suppliers and customers. The hours of work can be flexible but they might also be long and continuous. There are risks and frustrations too. If you are prepared and willing, then take the plunge.

**What is an enterprise?**

While the definition is obvious, it is necessary to understand the term ‘enterprise’ in a pragmatic manner. The term refers to any economic activity that involves:

* Tapping appropriate business opportunity
* Making investments in cash and/or kind
* Planning to anticipate obstacles and tackle the same
* Identifying and fulfilling ‘customer needs’
* Generating a cash surplus (profit) through the operations
* Doing things differently
* Being ‘time bound’ in all actions
* Exhibiting ‘control’ over the operations
* Introducing an element of ‘continuous growth’

All the above elements are necessary for success of an enterprise.

**Why focus on small enterprise?**

Irrespective of the stage of economic development of a nation, MSMEs find a prominent place for the following reasons:

Regional balance in development: Given the size and the scale of operations, MSMEs can be geographically dispersed. Hence, initiatives to help emergence of MSMEs lead to ‘regional balance’ in development. For instance, a small production facility to manufacture readymade garments could be set up in places other than urban areas since it does not call for significant support facilities such as industrial estate, sea/airport, ‘high voltage’ electricity and the like.

Value addition to local material resources: MSMEs can utilize local material resources leading to ‘value addition’ and ultimately benefiting the local economy. For instance, in a pace possessing rich reserves of lime stone, a factory to manufacture cement (a large enterprise) could be set up. However, adequate infrastructure (electric power for instance) may not be available. Under such circumstances, the natural resource (lime stone) could still be used to produce ‘hydrated lime’ in small scale.

Value addition to local human resources: Small enterprises could be set up based on local skills thereby leading to productive utilization of local manpower. For instance, small enterprises could be set up based on traditional skills in fabric making (weaving) thereby generating employment and reducing the instances of migration.

Employment generation: Small enterprises promotion is an effective way to generate employment opportunities given that they do not call for sophisticated and huge infrastructure facilities. It is said that the employment generation potential of MSMEs for a given level of investment is more than that of large enterprises.

Enhancing supply of entrepreneurs: In any economy, development is largely based on entrepreneurial activity. In developing economies, the supply of entrepreneurs could be restricted to those individuals from families possessing business background and communities that are ‘traditionally’ business oriented. Given that it is possible to assist those (technocrats for instance) not possessing such advantages to set up small enterprises through training and support interventions, the supply of entrepreneurs could be enhanced.

The success of a small enterprise depends on the following major factors:

1. An Entrepreneur
2. Inherent viability of the product, i.e., technical, organizational, financial and commercial viability.
3. The way a project is planned, i.e., decisions regarding various project parameters such as where to locate, what technology to use, what should be the capacity of the machineries, etc.
4. The meticulousness with which a project is implemented.
5. The way a project is managed.

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

In a small-scale enterprise or even in a medium scale enterprise, it is the promoter of the project, i.e., the entrepreneur who does most of the functions of project planning, implementation and management. If the size of the project is big enough to call for employing professional managers, it is the entrepreneur who acts as a driving force behind performance of these three aforesaid major functions. To be effective, an entrepreneur needs to possess certain knowledge, skills and appropriate personality profit. All these put together could be termed as Competencies.

***Summary:***

Individuals who are willing to tackle challenges leading to commensurate rewards are more likely to be entrepreneurs. However, it takes certain personal traits to be successful as could be seen from the next session. An entrepreneur has to struggle, overcome difficulties and hurdles in his/her path and reaches the goal.

Some of the charms of becoming an entrepreneur are as follows:

* Opportunity to gain control over one's own destiny
* Opportunity to reach your full potential
* Opportunity to reap unlimited profits
* Opportunity to contribute to society and be recognized for your efforts

**Chapter 2 Entrepreneurial Competencies – Awareness**

* 1. **What is a Competence?**

A Competence is an underlying characteristic of a person, which results in effective and / or superior performance in a job competence is an underlying characteristic of a person, in that it may be motive / traits / skills or aspect of one's self-image or a body of knowledge which one uses. The existence of these characteristics may or may not be known to the person. In this sense, the characteristic may be unconscious aspect of the person. In simple terms a competence is a combination of a body of knowledge, set of skills and cluster of appropriate motives / traits that an individual possesses to perform a given task effectively and efficiently.

It is scientifically proven that for an entrepreneur to be successful he must have the below detailed competencies; keeping in mind that the magnitude of these competencies might vary from one entrepreneur to the other.

**1. Initiative:**

Takes action that go beyond job requirements or the demand of the situation

Does things before being asked or forced to by events.

Acts to extend the business into new areas, products or services.

**2. Sees and Acts on Opportunities:**

Looks for and takes action on opportunities.

Sees and acts on opportunities (Business, Educational or Personal Growth)

Seizes unusual opportunities to obtain financing equipment, land work, space, or assistance.

**3. Persistence:**

Takes repeated or different actions to overcome obstacle.

Takes repeated or different actions to overcome obstacle.

Takes action in the face of a significant obstacle.

**4. Information Seeking:**

Takes action on own to get information to help reach objectives or clarify problems.

Does personal research on how to provide a product or service.

Seeks information or asks questions to clarify what is wanted or needed.

Personally undertakes research, analysis or investigation.

Uses contacts or information networks to obtain useful information.

**5. Concern for high Quality of Work:**

Acts to do things that meet or beat existing standards of excellence.

States a desire to produce work high quality.

Compares own work or own company's work favorably to that of others.

**6. Commitment to Work Contract.**

Places the highest priority or getting a job completed.

Makes a personal sacrifice or expands extraordinary effort to complete a job.

Accepts full responsibility for problems in completing a job for others.

Pitches in with workers or works in their place to get the job done.

Expresses a concern for satisfying the customer.

**7. Efficiency Orientation:**

Finds ways to do things faster or with fewer resources or at a lower cost.

Looks for or finds way to do things faster or at less cost.

Uses information or business tools to improve efficiency.

**8. Systematic Planning:**

Develops and uses the logical, step-by-step plans to reach goals.

Plans by breaking a large task down into sub-tasks.

Develops plans that anticipate obstacles

Evaluates alternatives.

Takes a logical and systematic approach to activities.

**9. Problem Solving:**

Identifies new and potentially unique ideas to reach goals.

Switches to an alternative strategy to reach a goal.

Generate new ideas or innovative to reach a goal.

**10. Self-confidence:**

Has a strong belief in self and own abilities.

Express confidence in own ability to complete a task or meet a challenge.

Sticks with own judgment in the face or opposition or early lack of success.

Does something that he says is risky.

**11. Assertiveness:**

Confronts problems and issues with others directly.

Confronts problems with others directly.

Tells others what they have to do

Reprimands or disciplines those failing to perform as expected.

**12. Persuasion:**

Successfully persuades others.

Convinces someone to buy a product or service.

Convinces someone to provide financing.

Convinces someone to do something else that he would like that person to do.

Asserts own competence, reliability or other personal or company's qualities.

Asserts strong confidence in own company's or organization's products or services.

**13. Use of influence Strategies:**

Acts to develop business contacts.

Uses influential people as agents to accomplish own objectives.

Selectively limits the information given to others.

User a strategy to influence or persuade others.

**14. Monitoring:**

Develops or uses procedures to ensure that work is completed or that work gets standards or quality.

Personality supervises all aspects of a project.

**15. Concern for Employee Welfare:**

Takes action to improve the welfare of employees

Takes positive action in response to Employees Personal Concerns.

Expresses concern about the welfare of employees.

**Chapter 3 Entrepreneurial Competencies – Self Analysis**

**SELF - RATING QUESTIONNAIRE**

Introductions

1. This questionnaire consists of 70 brief statements, Read each statement and decide how well describes you Be honest about yourself
2. Select one of the numbers below to indicate how well the statement describes you:

5 - Very well

4 - Well

3 - Somewhat

2 - Very little

1 - Not at all

1. Write the number you select on the line of the right of each statement. Here is example. I remain calm in stressful situations

The person who responded to the item above wrote a "2" indicating that the statement described him or her very little.

1. Some statements may be similar, but no two are exactly alike.
2. Please answer all questions.

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

1. I look for things that need to be done \_\_\_\_\_\_

2. I like challenges and new opportunities \_\_\_\_\_\_

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

solution. \_\_\_\_\_\_

4. When starting a new task of project, I gather a great deal of information \_\_\_\_\_\_

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

6. I give much effort to my work \_\_\_\_\_\_

7. I find ways to do things faster. \_\_\_\_\_\_

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

9. I think of unusual solutions to problems \_\_\_\_\_\_

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

11. I feel others when they have not performed as expected. \_\_\_\_\_\_

12. I get other to support my recommendations. \_\_\_\_\_\_

13. I develop strategies to influence others. \_\_\_\_\_\_

14. No matter who I am talking to, I'm good listener \_\_\_\_\_\_

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

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

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

18. I seek the advice of people who know a lot about the problems or tasks. \_\_\_\_\_\_

I am working on

1. It is important to me to do a high quality job. \_\_\_\_\_\_
2. I work long hours and make personal sacrifices to complete jobs on time \_\_\_\_\_\_
3. I am not good at using my time well. \_\_\_\_\_\_
4. I think about the advantages and disadvantages of different ways of

Accomplishing things \_\_\_\_\_\_

1. I think of many new ideas. \_\_\_\_\_\_
2. I change my mind if others disagree strongly with me. \_\_\_\_\_\_
3. If I am angry or upset with someone, I tell that person. \_\_\_\_\_\_
4. I convince others of my ideas. \_\_\_\_\_\_
5. I do not spend much time thinking about how to influence others. \_\_\_\_\_\_
6. I feel resentful when I don't get my way \_\_\_\_\_\_
7. I do things before it is clear that they must be done. \_\_\_\_\_\_
8. I notice opportunities to do new things \_\_\_\_\_\_
9. When something gets in the way of what I am trying to do, I keep on

trying to accomplish what I want. \_\_\_\_\_\_

1. I take action without seeking information. \_\_\_\_\_\_
2. My own work s better than that of other people I work with. \_\_\_\_\_\_
3. I do whatever it takes to complete a job. \_\_\_\_\_\_
4. It bothers me when my time is wasted. \_\_\_\_\_\_
5. I try to think of all the problems I may encounter and plan what to do if

each problem occurs. \_\_\_\_\_\_

1. Once I have selected an approach to solving a problem, I do not change

that approach. \_\_\_\_\_\_

1. When trying something difficult or challenging. I feel confident that

I will succeed. \_\_\_\_\_\_

1. It is difficult for me to order people to do things. \_\_\_\_\_\_
2. I get others to see how I will be able to accomplish what I set out to do. \_\_\_\_\_\_
3. I get important people to help me accomplish my goals. \_\_\_\_\_\_
4. In the past, I have failures. \_\_\_\_\_\_
5. I take action before it is clear that I must \_\_\_\_\_\_
6. I try things that are very new and different from what I have done before. \_\_\_\_\_\_
7. When faced with a major difficulty, I quickly go on to other things. \_\_\_\_\_\_
8. When working on a project for some, I ask many questions to be sure

I understand what that person wants. \_\_\_\_\_\_

1. When something I have been working on is satisfactory I do not

spend extra time trying to make it better. \_\_\_\_\_\_

1. When I am doing a job for someone, I make a special effort to make

sure that person is satisfied with my work. \_\_\_\_\_\_

1. I find ways to do things for less cost. \_\_\_\_\_\_
2. I deal with problems as they arise, rather than spend time trying to

anticipate them. \_\_\_\_\_\_

1. I think of many ways to solve problems. \_\_\_\_\_\_
2. I do things that are risky \_\_\_\_\_\_
3. When I disagree with others, I let them know \_\_\_\_\_\_
4. I am very persuasive with others \_\_\_\_\_\_
5. In order to reach my goals, I think of solutions that benefit everyone

involved in a problem. \_\_\_\_\_\_

1. There have been occasions when I took advantage of some. \_\_\_\_\_\_
2. I wait for direction from others before taking action. \_\_\_\_\_\_
3. I take advantage of opportunities that arise. \_\_\_\_\_\_
4. I try several ways to overcome things that get in the way of reaching my

goals. \_\_\_\_\_\_

1. I go to several differences to get information to help with tasks or

projects. \_\_\_\_\_\_

1. I want company I own to be the best of its type \_\_\_\_\_\_
2. I do not let my work interfere with my family or personal life. \_\_\_\_\_\_
3. I get the most I can out of the money I have to accomplish a project

or task. \_\_\_\_\_\_

1. I take a logical and systematic approach to activities. \_\_\_\_\_\_
2. If one approach to a problem does not work, I think of another approach. \_\_\_\_\_\_
3. I stick with my decisions even if other disagree strongly with me. \_\_\_\_\_\_
4. I tell people what they have to do, even if they do not want to do it. \_\_\_\_\_\_
5. I cannot get people who have strong opinions or ideas to change their

minds. \_\_\_\_\_\_

1. I get to know people who may be able to help me reach my goals. \_\_\_\_\_\_
2. When I don't know something, I don't mind admitting it. \_\_\_\_\_\_

**SCORING SHEET FOR SELF-RATING QUESTIONNAIRE**

Instructions:

1. Enter the ratings from the completed questionnaire on the lines above the item number in parentheses Notice that the item numbers in each column are consecutive: Item number 2 is below item number 1, and so forth.
2. Do the addition and subtraction indicated in each row to compute each competency score.
3. Add all competence scores to compute the total score.

**Rating of Statements Score Competency**

\_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_ + 6 =\_\_\_\_ Initiative

(1) (15) (29) (43) (57)

\_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Sees & Acts

(2) (16) (30) (44) (58) on Opportunities

\_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Persistence

(3) (17) (31) (45) (59)

\_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Information

seeking

(4) (18) (32) (46) (60)

\_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Concern for

High quality of work

(5) (19) (33) (47) (61)

\_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_ + 6 =\_\_\_\_ Commitment to

(6) (20) (34) (48) (62) work contract

\_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Efficiency

Orientation

(7) (21) (35) (49) (63)

\_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Systematic

Planning

(8) (22) (36) (50) (64)

\_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Problem

Solving

(9) (23) (37) (51) (65)

\_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Self-confidence

(10) (24) (38) (52) (66)

\_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Assertiveness

(11) (25) (39) (53) (67)

\_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ - \_\_\_\_ + 6 =\_\_\_\_ Persuasion

(12) (26) (40) (54) (68)

\_\_\_\_\_ - \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_\_ + \_\_\_\_ + 6 =\_\_\_\_ Use of Influence

(13) (27) (41) (55) (69) strategy

**TOTAL SCORE** =\_\_\_\_

\_\_\_\_\_ - \_\_\_\_\_ - \_\_\_\_\_ - \_\_\_\_ + \_\_\_\_ + 18 =\_\_\_\_ Correction Factor

(14) (28) (42) (56) (70)

**CORRECTED SCORING SHEET**

Instructions:

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

1. Use the following numbers when figuring the corrected score

If the Correction Subtract the following correction number

Factor score is from the total score for each competency

24 or 25 7

22 or 23 5

20 or 21 3

19 or less 0

1. Use the next page to correct each competency before using the profile sheet.

**CORRECTED SCORE SHEET**

Competency Original - Correction = Corrected

Score Number \* Total

Initiative \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Sees and Acts on Opportunities \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Persistence \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Information seeking \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Concern for High Quality of Work \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Commitment to Work Contract \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Efficiency Orientation \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Systematic Planning \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Problem Solving \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Self Confidence \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Assertiveness \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Persuasion \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

Use of Influence Strategies \_\_\_\_\_\_\_ - \_\_\_\_\_\_\_ = \_\_\_\_\_\_\_\_\_

CORRECTED TOTAL SCORE = \_\_\_\_\_\_\_\_\_

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

**Competency Profile Sheet for Self - Rating Questionnaire**

**Instructions**

1. Transfer the corrected competency score to the profile sheet by making an 'X' at the appropriate point on the dotted horizontal line for each competency.
2. Draw a heavy line over the dotted horizontal line for each competency, from the left vertical line to the point you have marked with an 'X'. The heavy lines you have drawn graphically represent the strength of each competency.
3. The following is an example of how to create the profile sheet.

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

Initiative

0 5 10 15 20 25

**S. R. Q. EXERCISE PROFILE SHEET**

Competency:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Initiative |  |  |  |  |  |
| Sees and Acts on Opportunities |  |  |  |  |  |
| Persistence |  |  |  |  |  |
| Information Seeking |  |  |  |  |  |
| Concern for High Quality of work |  |  |  |  |  |
| Commitment to work Contract |  |  |  |  |  |
| Efficiency Orientation |  |  |  |  |  |
| Systematic Planning |  |  |  |  |  |
| Problem Solving |  |  |  |  |  |
| Self Confidence |  |  |  |  |  |
| Assertiveness |  |  |  |  |  |
| Persuasion |  |  |  |  |  |
| Use of Influence Strategies |  |  |  |  |  |

0 5 10 15 20 25

Competency Scores

**Chapter 4 Opportunity Identification and Selection: The Process**

**1. Background:**

How does an entrepreneur go about identifying business ideas? There are numerous stories about different methods adopted by entrepreneurs for identification of a project. A chance event made one Mr Jamal launch a project to manufacture spectacle lenses. He lost a pair of spectacles in Singapore, discovered how expensive it was there and wondered whether he could produce them in back home for exports. On the other end, we have another person, Mr Khan who drew up a list of criteria for opportunity identification, engaged a group of consultants, identified twenty-five ideas, screened these further, short-listed five, undertook pre-feasibility studies on these and selected one- castor oil derivatives. There is no dearth of case histories. There is a plethora of business ideas. But there is precious little literature on the subject of identification process, methodology, sources of assistance and information. This manual is a modest effort, meant to be a blend of theory and practice. It is intended to help one think and chart out an identification work-plan for him/her. It does not provide neat, oversimplified answers because opportunity-identification in itself is an open-ended task. It is meant to enlarge insights, aid thought-process, clarify techniques and fine-tune the approach.

The Module deals with the following.

* Process of Opportunity Identification and Selection (OIS) :
* Sources of idea generation:
* Idea selection: This gives an insight into the process of preliminary evaluation of the ideas and of relating the same to one’s own background/resources and.
* OIS in ECP context: This covers the approach that a facilitator needs to follow to help the potential entrepreneurs firm up the business idea

**2. Opportunity Identification and Selection: The Process**

**2.1 The 6-Step Process**

An entrepreneur may select a business opportunity through a chance event or through a natural extension of his present occupation. For example, a trader in engineering goods undertakes production of the same. But then, everyone is not so lucky. One could belong to a class of entrepreneurs to whom opportunities do not present themselves so easily. So, there is a need to understand the OIS process. The process is outlined in Exhibit - 1

**Exhibit -1**

**OIS PROCESS**

The Steps

Preparation of Personal Profile Step 1

Development of OS (decision making) Framework Step 2

Generation of Ideas Step 3

Snap Investigation Step 4

Pre-feasibility Studies Step 5

Opportunity selection Step 6

**2.2 STEP 1: Preparation of Personal Profile**

The facilitator needs to prepare a ‘personal profile’ of each participant as per the sample below. The format could be altered depending on the local needs.

**Statement 1**

**Personal Profile**

1. Name : A Abbas

2. Education : University Degree in Science

3. Work experience : Production Supervisor in a large

boiler-producing company (18 months).

Marketing executive in a sophisticated printing

equipment producing company (10 months).

4. Other Academic/Practical

Interests : Electronics

5. Personality : Hard-working. Dynamic. An upper middle-

class background. Parents and close relatives

are either job-holders or self-employed

professionals. Initial financial assistance and

moral support assured by parents. But cannot expect support either in terms of term-loan tie-up, market entry or emergency financial assistance.

6. Objectives for establishing : To create wealth. There is optimism that

an enterprise if he works hard and makes sacrifices now, he

will reap a good harvest in a few years.

7. Investment Preparedness : Own fund of NCU 300,000 can be committed

to business. (NCU - National Currency Unit)

8. Attitude to Risk-taking : Hard earned money. Low risk attitude.

9. Personal Considerations : - Wants to set it up in/around the city where he

lives.

- Wants to do it alone. No partnership.

Such a profile helps the facilitator in defining the boundaries with in which one could look for business opportunities. Further, it facilitates evaluation of ideas (based on non-financial parameters)

**2.3 STEP 2: Development of Opportunity Identification Selection (OIS) Framework**

Being open to any opportunity under the sun might mean not taking any action at all. It is imperative that the potential entrepreneur develops one’s own list of criteria for OIS. This will help clarify expectations and provide a basis for opportunity search. The framework needs to focus on answering the following questions.

* + 1. Investment

How much money that one is willing to invest? It is necessary that the person arrives at a range with in which s/he can consider investment. To this one could add the funds that could be raised from financial institutions to arrive at the total investment. This shall lead to the upper limit of cost of the project that one could realistically handle.

2.3.2 Technological Sophistication

What is the degree of technological sophistication that one can handle? It is not enough to secure technical know-how, one has to absorb and adapt it to one’s purpose. For a small entrepreneur who does not have any technical background or experience, such absorption is difficult if the technology is complex. In fact, it is daunting task for such an entrepreneur to judge the soundness of a technical know how.

2.3.3 Managerial / Organizational Demands

How large or complicated is the managerial / Organizational task? How does one’s own education, skills, experience match this task? All enterprises involve management. It is the intricacy of managerial functions and one’s capability, which needs to be focused upon. Take the example of a technician who is only a school graduate and his experience is limited to supervising workers in a small automobile-service company. He chooses to manufacture power-coils, which involve 22 kinds of raw materials, three of which are imported. Besides, the product needs to be sold in 10 to 15 cities through a network of dealers. There is the danger of his capabilities falling short of the procurement, production-scheduling and marketing demands inherent to the project.

2.3.4 Market and Competition

One often comes across entrepreneurs looking for "monopoly'' business opportunities. The search is often futile because such opportunities seldom exist, Even if they do; they are, in most instances, beyond the financial and technological reach of small entrepreneurs. The expectation underscores a certain attitude to market and competition. Is it that one is competition-shy or is prepared to fight to make room for oneself in a somewhat crowded market place? Answer this question before scouting for specific opportunities.

2.3.5 Sector Preference

Following factors could influence the sector or industry preferences:

* Educational background
* Work-experience
* Exposure to business
* Network of contacts
* Location-choice

Based on the above, right at the outset, one might decide to look for an opportunity in, say, chemical or plastics. Also, one might have an aversion to certain types of businesses. So, one’s preferences and aversions are to be stated as clearly as possible.

2.3.6 Government Intervention/Dependence

One could have certain preferences based on the possibilities of government interventions/controls on certain types of businesses or dependency on the State as large customer. For example, there could be price control on finished goods (like some pharmaceuticals products for instance). Or, there could state control on access to certain raw materials. While some entrepreneurs thrive on such situations, many are averse to it. So, one’s preferences have to be defined.

* + 1. Profitability

Everybody looks for a profitable project but individual expectations vary. An existing entrepreneur manufacturing chemicals said that he would consider 20% return on investment quite good. A trader, aspiring to be an entrepreneur, judged this to be thoroughly unacceptable. Thus, it is advisable to state one’s expectations.

* + 1. Nature and extent of Risk

All business opportunities entail risk but the degree varies. Risk stems from various sources - government policy, raw material supply, market, technology and the likes. If it is an innovative product, the risk levels could be relatively high as against an established/known product. There are techniques (break even point, sensitivity analysis) of measuring risk. Thus, one has to decide the degree of risk that is acceptable. Which form of risk that one could confidently handle? Which form of risk that one wishes to avoid at all cost?

* + 1. Location

Most small entrepreneurs establish projects at a location near to their normal place of residence. However, there are those who wish to migrate to their native place (if they are now living else where) or some other location. Unless one has an open mind, it is necessary to outline one’s location preferences. This could possibly act as boundary for opportunity search.

* + 1. Personal Considerations

The range of personal considerations underlying OIS is likely to be defy limits. This is an aspect of OIS-work which has received scant attention. In many cases, these considerations surface clearly after a project is set up. It is not possible, often to, fulfill personal considerations and hence these may have to be relaxed. Presented below are illustrations of such considerations:

1. Life Style

Mr. Abbas is a successful trader. He has got a number of coveted agencies. He is an engineering graduate. But, now he has to spend time hobnobbing with local traders. They have limited formal education. There are late-night parties at which the level of conversation is pedestrian. He is a man of considerable intellectual and cultural propensities. He is happy with material success, but regrets the life-style determined by his chosen vocation. He wonders whether he should have ventured into something else. His advice to new entrepreneurs is, "It is good to wish to become rich. But ask yourself - become rich, doing what?”

(ii) Relative Importance of Money

Mr Ahmed comes from a textile magnate family. He got bored being a mere addition to the work force amongst the family members. After two years, he decided to seek challenges by way of setting up his own enterprise. He had to spend 10 hours a day managing it. If he was not present, the clientele and revenue would decline. It meant he had to sacrifice his own hobbies and social life. He thought that the limited income from his small venture was not worth the bother and the hardship.

1. Speculative Orientation

Take the case of Samir who has made a significant investment in an engineering project in a rapidly developing part of the town. The investment in land and building is very high. Among others, this is one cause for the enterprise remaining in the red (making losses). He, however, is not unhappy. His eyes are set on potential appreciation in land/building prices. He is, in a way, not firmly committed to the project. He is making an effort. If it takes off, well and good, if it does not, he hopes to make a tidy profit from sale of land and building. This has been his calculation from the beginning. So, he is an entrepreneur and speculator - rolled into one. He might as well have chosen some other project. It would have made marginal difference.

(iv) A rich businessman has got household – appliance sale-cum-service centre opened for his son. There is not much money in the business. In fact, not much money was expected. The main intention was to keep a wayward son meaningfully occupied.

Look at Statement-2 for an (illustrative) understanding of OS developed by Abbas.

**STATEMENT 2**

**OS FRAMEWORK DEVELOPED BY ABBAS**

1. Gross Investment : Maximum NCU 800,000

2. Gestation Period : Can bear a small loss in the first year. Must break even or generate some cash profit in the second year.

3. Profitability : Should yield minimum 25% return on investment from third year onwards.

4. Market : Need not be a monopoly but not an

overcrowded market. Avoid consumer products because these involve an elaborate distribution network and expenditure on publicity. Interested in steady demand. Interested in export because there is government support for it and believes that there are good opportunities there.

5. Government restrictions: Wants a business on which Government restrictions are minimal.

6. Linkage with overall : Does not want a product or service which is Economy linked too much with economic upswing or downswing. For example, wants to stay away from automobile parts and consumer durables because these are hit

quite hard by recession.

7. Future Growth : This is important. Wants to stay in this business for a long time.

8. Sector Preferences : No strong preferences except that he will like to

avoid consumer products because of inherent risk and chemicals because lack of technical knowledge that will deprive him of any special advantage vis-a-vis competitors

9. Personal Consideration: The business should use the knowledge and

skills that he possesses. It should be

respectable.

**2.4 STEP 3: Generation or Identification of Ideas**

The range and depth of ideas are determined by various factors like the nature of one’s exposure to business environment, business acumen, vision, confidence and scanning or scouting capability. There also is a strong creative dimension. There are no sure-fire ways of picking up opportunities. There are, however, methods which help one get started on an identification journey and cover the ground rapidly. There are sources of information/assistance with which one needs to familiarize. The subject of idea-generation has been discussed separately.

**2.5 STEP 4: Snap Investigation of Ideas**

Generating a business idea is not good enough. One has to examine its viability. Since, at this stage, one could be considering several opportunities, it is not possible to spend your time on detailed investigation of viability of each of them.

Snap investigation refers to assessing the prima-facie viability of these ideas in terms of one’s own OIS (decision-making) framework. It is not a neat, completely structured evaluation; there is room for intuitive judgment or gut feeling

So, what needs to be done? One needs to talk to the following:

* Entrepreneurs engaged in similar business
* Potential customers

- Knowledgeable officials in agencies assisting industry

* Consultants and
* Machinery suppliers.

In addition to the above, one has to refer to relevant published material.

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At this stage, one can, often, ill-afford the cost of a comprehensive project investigation. A pragmatic approach that combines snap investigation and evaluation of business ideas for the purpose of short listing is by way of finding answers to the questions as indicated in Statement 3. The answers are based on published materials, observation and interactions with knowledgeable persons.

While answering questions as per Statement 3, it is necessary to assess the business idea in relation to OIS decision making framework as indicated in Para 2.3 above.

The exercise has to lead to short-listing of ideas with just about 2 or 3 of them. However, at any point of time during preparation of pre-feasibility study and business plan, one has to be open to any new information that could validate an idea earlier eliminated from the short-list or an altogether new idea.

**Statement 3**

**Snap Investigation of Business Ideas:**

**A Checklist**

1. **General**

* What is the basic concept of the project?
* Any developments in the pipeline that may affect the project adversely?
* Is there a niche for the project output?

1. **Cost of the project** :

* Are there sources of finance?
* Are there entrepreneurs with sufficient equity?

1. **Technology :**

* Is the technology imported/indigenous?
* If imported, does the Government policy allow the same?
* Is it sophisticated?
* Are there potential entrepreneurs qualified to match the needs?
* How difficult it is to acquire the technology?
* Are skilled workers available?
* If re-training of workers is required, are facilities available and accessible?
* How critical is repairs / maintenance?
* Are repairs and maintenance facilities available in the region?

1. **Management :**

* How complicated will be the managerial task?
* Can potential entrepreneurs with requisite background be identified?
* Can the requisite managerial/ supervisory skills be hired locally?

**E. Marketing**:

Customers

* Who are the customers?
* What are their needs?
* To what extent the proposed product meets the customer needs?
* Are the customers brand-conscious?
* If yes, can the entrepreneurs invest in establishing brand image?
* What is the pace of change in the customer’s tastes and preferences?
* To what extent such a change will affect the project
* If the project’s output is by way of import substitution, can the quality and price be matched? Will it be acceptable to the consumers (fancy for imported goods)?

External factors

* What are the expected geographical boundaries?
* Can they be reached given infrastructure constraints?
* Is the demand seasonal?
* If yes, can the project’s strategy manage the seasonality?
* How volatile is the selling price?
* Are there any substitutes for the project’s output?

Competition

* What is the degree of competition?
* What is the basis of competition?
* Reactions from similar existing projects to a new entrant: Can these be managed?
* What is the competitive advantage/disadvantage of the new project in relation to existing ones?
* How the new project’s output different from that of the existing ones?
* What are the advantages of the project’s output over the available substitutes?

1. **Raw materials :**

* Are they indigenously available?
* If not, can they be imported at ease?
* Does the Government policy permit such imports?
* Are there any constraints in accessing the raw materials (transport bottlenecks)?
* Is there speculative trading in raw material or finished goods?
* How volatile is the price of the raw material?

1. **Infrastructure:**

* Are there any guidelines/ restrictions on the project’s location?
* How feasible it is to locate the project at a place that is most suitable?
* Are there any constraints in availability of electricity, water and effluent disposal facility?
* Is the project critically dependent on a given infrastructural facility?
* If yes, what is the degree of certainty in accessing such a facility?

1. **Sub-sector:**

* Is the sub-sector to which the project’s output belongs a growing one?
* What is the element of risk in the sub-sector as compared to other sub-sectors?
* How much of attention the Government pays on the sub-sector in comparison to other sub-sectors?

1. **Government policies:**

* Are there any entry restrictions?
* Are there any prescribed quality standards?
* If yes, how difficult it is for the project to meet the same?
* Are there any Government controls over the price of the project’s output as also the raw materials?
* If the technology, raw material and/or equipments are imported, does the Government policy allow the same?
* To what extent the project can take advantage of incentives?
* Are there any Government controls on profit margins and distribution?

**J. Consideration of entrepreneurs:**

How does the project relate to some of the considerations of potential entrepreneurs in general? Such considerations could be:

.

* Upper limit of Investment
* Technological Sophistication
* Managerial / Organizational Demands
* Market and Competition
* Sector Preference
* Government Intervention / Dependence
* Extent of profitability
* Nature and extent of Risk
* Location
* Personal Considerations such as taboos/religious sentiments, lifestyles, family preferences and the like

All the above questions have to be answered, though tentatively. A comprehensive picture on available options will put you in a clearer frame of mind. The answers to these questions are not in themselves a business plan - - a plan of action together with its financial implication - - although they will certainly help you to draw one up.

* 1. **STEP 5 : Pre-feasibility study :**

Prior to preparing a business plan, it is necessary to get a comprehensive picture of the business idea by way of preparing a pre-feasibility study. If a thorough job is done while working on ‘snap investigation’ (Statement 3 above), one could have accomplished this task substantially. However, there is a need to have at hand facts and figures by way of a pre-feasibility study. Such a study will help decide whether it is worth pursuing the option further. Alternatively, if one is confident of the findings of a snap investigation coupled with the answers to the questions listed in Statement 3, one may consider skipping this Step. A sample pre-feasibility study is covered under Statement 4.

* 1. **STEP 6 : Opportunity selection :**

This is the penultimate stage in OIS process. Until now, it was exploration, information gathering and analysis. Apart from the facts and figures that establish the viability of a given business idea, it is necessary that one takes cognizance of one’s strengths and weaknesses while making a final selection of the business idea. It is important to note that investment decision is to be based on further exercise of preparing a feasibility study/business plan.

**Statement 4**

**Gypsum Board - A sample pre-feasibility study**

1. **Product and its applications :**

Given the increasing prices of wood and the need to conserve natural forests, alternative materials like Plastic and Mineral field composites are being developed. Gypsum is an inexpensive material available abundantly. It can be reinforced with glass fiber to make boards and blocks that have a good texture, impact strength and workability similar to wood, apart from being fire resistant.

The Glass Reinforced Gypsum (GRG) boards can be used in building construction and furniture industry to produce doors, windows, table tops etc. Apart from being cost effectiveness, GRG is amenable to addition of pigments and surface glazing that provides a good finish.

1. **Market potential :**

There are no manufacturers of GRG boards in the country as of now. Given limited imports, it is not yet very popular. However, going by the demand projections of furniture industry and the qualities of GRG that could replace wood to some extent, it is expected that market size for GRG boards will be in the order of 7 to 10 million square meters.

1. **Project capacity :**

The minimum economic size of the project in terms of output is 50,000 square meters of boards with standard size of 32 inches x 16 inches. During the first year, the capacity utilization is expected to 50%.

1. **Manufacturing process :**

The GRG boards are manufactured by using a mixture of Gypsum (Plaster of Paris) and glass fiber shavings. The mixture is placed in moulds and allowed to set in a dryer. A surface coating of top quality Plaster of Paris mixed with pigments and polyester resin is applied to the board to give a colorful surface. The molded board is then allowed to cure.

1. **List of Plant and Machinery :**

* Plaster mixer (600 liters/hour capacity)
* Molding machine with vibratory system and monorail
* Spraying machine with pump
* Weighing and batching machine
* Drying and curing chamber
* Compressor
* Mould boxes (of various shapes and sizes)
* Surface glazing mixture and dispenser

Total cost: NCU 50,000 (NCU - National Currency Units)

1. **Raw materials and consumables :**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Particulars | Quantity | Value (NCU) |
| . | Gypsum/Plaster of Paris | 100 Tons | 6,700 |
| . | Glass fiber chopping | 10 Tons | 28,000 |
| . | Polyester resin and additives | As per needs | 11,500 |

1. **Requirement of infrastructure facilities :**

* Land - 3,000 square meters
* Building (built-up area) - 800 square meters

1. **Manpower :**

* Supervisors - 3 numbers
* Skilled workers - 7 numbers
* Unskilled workers - 18 numbers
* Office staff - 8 numbers

Total - 36 persons

1. **Utilities :**

* Electric power - 40 kilowatts (connected load)
* Water - 20,000 liters per day

1. **Cost of the Project :**

|  |  |  |
| --- | --- | --- |
| Sl # | Particulars | Amount (NCU) |
| 1. | Plant | 4,500 |
| 2. | Buildings | 27,700 |
| 3. | Machinery | 50,000 |
| 4. | Dyes, jigs and fixtures | 10,000 |
| 5. | Preliminary and pre-operative expenses | 6,700 |
| 6. | Contingencies | 6,000 |
| 7. | Miscellaneous assets | 1,700 |
| 8. | Working capital margin | 14,000 |
|  | Total | 120,600 |

Gross working capital is NCU 42,000 out of which NCU 14,000 will be promoter's contribution.

1. **Profitability estimates (1st year) :**

Particulars Amount (NCU)

* Sales turnover 128,800
* Cost of Production (includes depreciation,

financial charges & overheads) 106,600

* Net operating profit before tax 22,200
* Net operating profit as % of sales 17.2%

**Chapter 5 Sources of Information**

Information is the most essential element at various operational levels of a business, especially in the decision making process. The value of information is directly dependent on the content, relevance and timeliness of access to information. In this context, for the access of right information at the right time, one has to be aware of the various sources of information, services being offered and the existing information systems.

The information sources are to be targeted based on the information needs and in our context of start‑up, management and growth of a business enterprise we need to classify our needs. Broadly classified the needs identified are as follows:

*Business Opportunity*: Identification and selection of business ideas.

*Natural Resources*: The information of natural resources available, which depends on the geographical location of the enterprise.

*Product Information*: The information relating to the raw materials required and suppliers, machinery required and the suppliers of the machinery, technology of manufacture, market information and production and trade statistics.

*Financial Information*: The various avenues of financial assistance and the addresses of these institutions along with the details of these schemes.

*Regulatory/Legal Information*: The industrial laws, government norms and procedures, incentives and related information.

*Export/Import Information*: The procedures, opportunities and statistics.

*Management Information*: The information regarding management of money, materials and human resources. Also includes information regarding training and educational resources available.

The above listed information needs are broadly classified from an entrepreneur's point of view and gives us a good start in our task of identifying various information sources. Now, coming to the information sources, they are mainly institutions, individuals and other sources.

Institutions may be government or non‑government and include research institutions, training institutions, libraries and documentation and information centers.

The organizations may be industrial development bodies, financial institutions, trade promotion organizations, sector specific institutions like rural development banks, export promotion bodies, women development organizations and so on.

Individual sources of information may be consultants, entrepreneurs, researchers, experienced employees, trainers, friends and family members. Interactions with individuals are always of great help in getting a better perspective of your business, which you may have otherwise missed.

Other sources are print and non‑print sources of information, where print sources include Primary, Secondary and Tertiary sources. Primary sources include those sources which record nascent or new information being generated like periodicals, newspapers, trade literature, patents, newsletters, research reports and so on. The secondary sources include information derived from primary sources like bibliographies, surveys, abstracts, handbooks and encyclopedias. The tertiary sources are directories, text-books, guides, etc where the information is derived from primary and secondary sources of information.

**Chapter 6 Market Assessment**

**An Introduction to Marketing**

Marketing is often equated to selling. Although selling is an important part of marketing, it is not all of it. Marketing includes the entire range of activities aimed at giving people the product or service they want to buy but also giving it to them in the most effective and profitable manner.

Marketing approach is based on the principle that a business will survive only by meeting the needs and wants of its customers and would prosper by doing this better than its competitors. Market orientation therefore means that the entrepreneur thinks about the customer, studies their needs and offers products/ services to satisfy the same. Identifying why people buy rather than what they buy is an essential part of market orientation. The end result of market orientation is that the entrepreneur manufactures what he could sell to the customer and not attempt to sell what he can manufacture without relevance to consumer needs.

***4 P’s of Marketing:***

Thus, marketing involves finding answers to the following basic questions:

* What to produce and for whom? What ‘needs’ the product/service is intended to satisfy?
* How to create demand for the product/service?
* How to distribute the product/service effectively?
* How to price the product/service?

In marketing language the said questions can be translated to what is popularly known as 4P’s – Product, Promotion, Price and Place. The essence of Marketing involves:

* Understanding customer needs
* Designing the products/ services to meet those needs
* Pricing them keeping in view the value that they offer the customers
* Reaching the product/ service to the customers in a cost effective and convenient manner
* Seeking clients through promotional strategies - developing awareness and persuading people to by the product/ service.

# Market Assessment: An Overview

**Introduction**

Considering that survival and growth of an enterprise are a function of understanding customer needs and satisfying them in a “profitable” manner, it is important to study the marketing to understand:

* The customers
* The competitors
* The environment

Let us look at the extracts of a report prepared by an Entrepreneur wanting to set up a factory for manufacturing detergent powder.

# Per-capita consumption of detergent powder

In India - 0.3 Kgs/year

Population of the State - 29 million

Therefore total demand for detergent powder

(0.3 x 29 million) - 8,700 Tons/year

Current production of detergent powder in the

State - 1,700 Tons/year

Therefore demand-supply gap - 7,000 Tons/year

Capacity of proposed unit - 500 Tons/year

Capacity as percentage of demand-supply gap - 7%

The entrepreneur may consider that the project is a viable one from marketing angle since he aims at just about 7% of the market share. To the entrepreneur, the term “demand” seems to be just a matter of Arithmetic.

**2. Market Demand**

A proper understanding of the term “Demand” is essential pre-requisite to market study. For, various elements incorporated in the term “Demand” - give clues to the aspects of the market that need to be studied.

Market demand is a six-element concept. Market demand for a product is the total volume that will be bought by a defined customer group in defined geographical area in a defined time period and in a defined environment. Let us explain these elements.

1. Product:

Market demand pre-supposes a careful definition of the product or product class. Taking the example of a furniture manufacturer, the promoter must decide whether to standby the entire furniture market or focus on that segment of the market that wants high value designer furniture. The decision depends upon how the promoter perceives the opportunity for entering a chosen segment.

1. Volume :

The Market demand can be measured in terms of either volume of business or value in terms of money or both. Volume is useful measure when the product is homogeneous. You do not have to collect historical sales for price level changes, if you use volume. However, if the product lacks homogeneity, you are forced to use monetary unit. In the context of market studies, it is useful to generate physical volume estimates of sales as also to arrive at growth trends over the years to come.

1. Customer Group :

The demand may be measured for the whole market or for various customer groups or segments separately. For example, you analyze furniture demand for household and institutional (offices, shops, hotels, hospitals, etc.,) segments separately. You may decide not to count upon demand from specific segments on account of product limitations or organizational technology, manpower, skills, location, managerial capability, state or organizational constraints, development and financial resources vis-a-vis customer profile of individual segments decide what segment you must cater to or stay away from. A producer of electronic instruments may choose not to sell to defense establishment in view of its stringent quality standards, till he can reach such standard of quality in his unit.

1. Geographical area :

Market demand should be measured with reference to a well-defined geographical area. New entrepreneurs often do not have organizational resources to sell on a nation-wide scale. There are products which have to be marketed only within a certain radius form the location of the unit, e.g. corrugated box, industrial gas, collapsible tubes or prefab structures.

1. Time Period

The market demand must be forecasted for a specific time period. It is customary, for the purpose of a market study, to estimate demand for 5 or 8 or 10 years form commencement of production.

1. Market Environment :

Market demand estimates for an enterprise is subject to a given socio-economic environment. Radical policy changes or cultural upheavals will upset the demand estimate.

**3. Steps Involved In Market Assessment:**

While the depth of the study and extent of sophistication could vary depending on the complexities of the market conditions and the activity level of the enterprise, it is essential that the entrepreneur studies the market following a systematic approach. The steps involved in such an approach are indicated below:

* Deciding market assessment objectives:

It is not enough for an entrepreneur to arrive at “demand forecast”. What assumes importance is understanding the customer needs and thereafter working out ways and means of responding to the same. Considering that market study is not an academic exercise, the entrepreneur needs to clearly answer the question - what is that he wants to find out through a market study? Obviously there can be many answers to this question. The entrepreneur needs to priorities the objectives by classifying them into essential, desirable and ignorable. Such decisions help the entrepreneur in allocating an optimum amount of time and efforts for the study.

* **Identifying information needs** :

Having priority objectives, a list of information that one needs to collect has to be spelt out. The information needs are to be linked to the objectives of market study.

* Identifying methods of gathering information:

The entrepreneur could gather such information using a variety of approaches, the simplest way is going through published data and talking to a few knowledgeable persons. Such an approach is called exploratory-cum-desk study.

The entrepreneur may decide to talk to the talk to the prospective/existing customers or first hand information. In other words this would involve primary data collection. A very sophisticated nature of gathering information with respect to those products which are ‘new’ as far as the market segment is concerned is, test marketing.

* Analyze the information:

The information gathered has to be related to the basic questions that the entrepreneur wanted to answer. Such an analysis has to facilitate decisions on various aspects of market Programme.

Various steps involved in data collection are discussed separately.

# SUMMARY

## *Essence of Market Assessment*

* Market Assessment is not just demand assessment
* Demand assessment is not merely a question of statistics
* Market assessment involves gathering information to understand:

- The Customers

- The competitors

- The Environment

* Such understanding should lead to decisions on:

-Product features

-Packaging

-Pricing

-Ways and means of attracting customers

-Ways and means or reaching the product to the customers

* Before Market Assessment Exercise:

## Define the area - Product/segment/geographical area

* During Market Assessment, focus on:

Drivers of Demand and their sensitivity

**Chapter 7 Business Plan preparation**

**Guidelines for preparation of Business Plan**

Once a tentative decision is made to pursue a given business opportunity, the next stage is to prepare a Business Plan (BP). A thoughtfully prepared BP is an important tool as it helps him in anticipating and solving problems. It has been experienced that in preparing DPR, the entrepreneur is forced to consider several financial and implementation problems well in advance, giving him enough time to solve or prepare for them.

1.  ***For whom is the BP meant?***

The BP is meant for the entrepreneur himself and it is an essential document to procure assistance from financial institutions and to fulfill other formalities for the implementation of the project.

2. ***Who prepares the BP?***

Many a times an entrepreneur feels that he could relieve himself of the botheration to prepare a BP by engaging a consultant. Experience in developing entrepreneurs has convinced us that a well perceived, well-made BP by the entrepreneur himself is helpful to him while running the industry. This is so because, the process of preparing the BP 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 preparation of the BP.

3.  ***What can a BP tell?***

(a) A BP forces you to think and plan for future, which at that particular moment does not involve any finance.

(b) It helps you to realize what you need for implementing the project.

(c) It also gives you a general idea of your resource requirements and means to procure them.

(d) It shows the feasibility and probability of achieving profit.

(e) It gives you an indication of likely returns and benefits you will derive from your unit.

Thus, it helps you in visualizing financial rewards, needs, commitments and actions.

4.  ***What is the BP composed of?***

The report is a written document consisting of the followings:

(a) Assumptions/Estimates: for production, sales, raw material consumption, manpower needs, prices etc.

(b) Projections: financial, production, sales etc.

(c) Information: on technology, competition, prices etc.

(d) Calculation: Costs, profitability, cash flow etc.

(e) Documents: Machinery and raw material price quotations, constitutional information such as partnership deed, documents for infrastructural need like, land, building, land title, lease deed, rent deed etc.

5.  ***How to prepare The BP?***

A BP may be prepared in many different ways provided it includes all the above information. But it would be a satisfactory report if the following aspects are adequately covered and explained appropriately.

***Introduction of the Project Selected:***

The details which would be elaborated under this point are: (a) the product you have selected, (b) the usage of that product in that area, region or country, (c) future demand of the product in the market area you plan to serve. A short note on the demand and supply position of that product, reasons for selecting it; whether it is an import substitute or an export product and general prospects of commercial success should be prepared.

***Entrepreneur's bio‑Data:***

i) Entrepreneur's personal information: name, address, age, family background etc.

ii) Educational qualification (degree/diploma) and other training.

iii) Work experience, specialized capabilities and any other relevant data.

**Note**: If your education, training and work experience is related to the product that you have selected, you should give a detailed note explaining the relevance of your experience for the proposed project.

***Market Analysis:***

Reasons of going into production of the selected item raises the necessity of preparing a detailed market survey report preferably by the entrepreneur himself. Market survey report covers the competitors, machinery/raw material suppliers, traders, clients and their future requirements. This can be given in a chart/table form, which could be self‑explanatory. It would be better if the entrepreneur gets a few letters from future clients, machinery/raw material suppliers to make the BP more credible.

***Lay out details about the unit***:

(a) Proposed constitution of firm such as proprietorship/partnership, limited company etc.

(b) Reasons for selecting the particular location.

(c) Details of factory shed‑rented/ready etc.

(d) Details of the total area expansion provision

(e) Details of electrification of the factory

(f) Plan layout

(g) Expected cost of land and building

***Project Engineering:***

(i) *Preliminary Information*: Information such as the required finances, `No Objection Certificate' from concerned authorities, registrations with various departments (if needed). Need for trial production and arrangements made. Calculation of preliminary and preoperative expenses such as expenses incurred before trial production, advertisements, expenses while getting loans, furniture and fixture and other expenses.

(ii)*Production Programme*: According to the market estimate, first year's production programme with needed working shifts, (whether 1, 2 or 3), should be indicated. Similar calculation for second and third years should also be done. If needed, a chart also could be attached.

(iii)*Production Procedure:* Details on technical aspects of the product and the process of manufacturing step‑by‑step with plant layout should be given. At the end, a special quality control note should also be made.

(iv)*Raw Materials:* Principal raw‑materials needed and their specifications:

* Availability of the raw materials, its quality and feasibility of procuring the same regularly.
* Calculation on the required raw‑material stock according to availability of the same.
* Total value of raw material needed in one year (including transportation charges/other charges-if any).

(v) *Consumables/Utilities*

(vi)  *Machinery*: Cost estimates for machinery should be made. In computing value of machinery and equipment's sales tax, transportation and insurance costs should be added. Cost/Price escalation (say 10%) should also be provided for:

* Installation expenses of the machinery should be mentioned separately.
* Importance of each machinery and production capacity per hour should also be mentioned.
* Quotations should be obtained from 3 reputed/recognized parties for comparative study.

(vii) Personnel *Requirements:*

* Factory staff, their number, monthly and yearly emoluments.
* Administrative staff, their number, their monthly and yearly emoluments.
* Sales staff, their number, and yearly emoluments.

If any special technical personnel are required then need and availability should be explained.

1. *Other Administrative Expenses***:**

- Stationery and printing

- Postage

‑ Telephone and trunk‑calls

- Traveling

- Business magazine subscriptions

- Technical and legal fees

* Advertisement expenses

- Monthly payment to sales persons

- After sales services

- Miscellaneous expenses

(ix) *Working Capital Calculation*

            a) Raw material stock. (Days/weeks)

b) Goods under process. (Days/weeks)

c) Finished goods stock. (Days/weeks)

d) Stores and spares

e) Monthly expenses

(x) *Total Cost of the Project:*

a) Fixed Capital.... Land & Building, Machinery & Equipment's

b) Preliminary/pre‑operative expenses

c) Working‑capital

d) Provision for contingencies

(xi) *Financing of the Project:*

a) Own investment

b) Capital subsidies from government, if any

c) From friends and relatives

d) Long‑term loan from banks/corporations

e) Short‑term loan from banks

f) Trade credit

Total financing must match total project cost.

(xii) *Profitability Calculation*

Estimated profitability and financial ratios:

|  |
| --- |
| Sr. Details 1st 2nd 3rd  No. year year year |
| 1. Sales Revenue  2. Estimated Production Expenses  3. Production Profitability  4. Other Income   1. Profit Before Tax 2. Expected income‑tax to be paid   7. Net profit  8. Net cash returns (item no.7+depreciation+investment allowances)  9. Percentage of Net Profit  i) On Sales (item no.7 item no.1x100)  ii) On Investment |

(xiii) Break*‑Even Point Calculation and Explanation:*

Percentage of Break Even = Fixed Expenses/Expected Contribution x 100

Contribution = Income from sales ‑ variable expenses

(xiv) *Cash Flow:*

*1st 2nd 3rd*

*Financial Inflow year year year*

a) Net profit (income tax and

interest added but depreciation

added back)

b) Own investment

c) Depreciation

d) Investment allowances

e) Long‑term loan

f) Short‑term loan

g) Other income

Total

*Financial Outflow 1st 2nd 3rd*

*year year year*

a) Preliminary and

pre‑operative expenses

b) Fixed investment

c) Increase in current assets

d) Reduction in long‑term loan

e) Reduction in short‑term loan

f) Interest

g) Income tax

Total

3)  *Repayment of Loans 1st 2nd 3rd*

*year year year*

a) Net profit (income‑tax debited)

b) Entrepreneur's drawings

c) Available Profit (a‑b)

d) Amount to be returned to

financial institutions

e) Interest on funds availed.

4) *Project Implementation (in weeks)*

a) Preliminary survey of product

b) Market research and preparation of BP

c) Loan application, preparation and sanction

d) Selection of place and other necessary formalities

e) Machinery and equipment's order

f) Construction of factory building/rented building

g) Machinery and equipment's installation

h) Selection of personnel

i) Electricity, fuel application and formalities

j) Other necessary licenses and sanction letters necessary for implementation

k) Electrification in factory

l) Trial Production

m) Commercial Production

n) Necessary training

o) Inauguration of factory

p) If possible, add PERT‑CPM Chart

5) *Enclosures*

a) Educational certificates

b) Experience certificates

c) Testimonials for license and permission letters

d) Map of factory building and expected cost of building or rent receipt.

e) Quotations of machinery and equipments in triplicate.

f) If possible, letters from raw material suppliers

g) If possible, letters from future clients

h) Partnership deed or any other documents.

1. Financial *Features At A Glance*

|  |
| --- |
| Sr. Details Entrepreneur's Long term Short term Total  No investment loan Bank loan  --------------------------------------------------------------------------------------------------  1) Land and Building  2) Machinery & Equipment  3) Working Capital   1. Preliminary and   pre‑operative expense  5) Total   1. Expected total production   Expenses  7) Profitability  8) Expected net profit(less income tax)  9) Percentage of net profit on sales and on fixed capital  10) Percentage of BEP |

7) *What Precautions Should an Entrepreneur Take?*

a) Always estimate your costs to be higher and your income less than anticipated.

b) Do not put any cost/price unless you have checked and verified this information yourself. You must go personally into the market and confirm as much information as you can.

c) Do not take any data directly from some other BP without updating them.

d) Consider the implementation time. The time when you prepare the report and the time when you implement the project would differ. Make necessary escalation provisions due to the same.

e) Do not consider full utilization capacity in the first year. An enterprise takes time to start, settle and adjust. You may assume between 50 to 60% capacity utilization in the initial period.

f) You must prepare BP yourself.

g) Counter‑check all calculations, like cost of Project should match means of finance.

h) Do not hesitate to take advice or opinion of other experts.

8) *Where Does the BP Fail?*

a) Estimating proper utilization of capacity

b) Not providing sufficient contingency provisions

c) Not providing cushion for fixtures, electrification

d) Not providing cushion for handling and other time loss.

e) Making it rosy for others, without looking into reality

f) Not getting all relevant and up-to-date information and supporting documents

g) Over enthusiastic estimate for income and optimistic estimates about expenses.

***Summary:***

The detailed BP is meant for the entrepreneur and is also an essential document to procure financial assistance from financial institution and to fulfill the formalities for implementation of the project.

As far as possible an entrepreneur should himself/herself prepare the report. The report is composed of:

1. Assumptions and estimates for production, sales, raw material consumption, manpower needs, etc

2. Projections ‑ financial, production, sales, profitability

3. Information on technology, competition, prices

4. Calculation of costs, cash flow

5. Various documents required

6. Information about the entrepreneur

7. Market analysis

8. Details about unit

9. Production programme and procedure

10. Land, building, machinery, equipment and utilities

11. Working capital

12. Financing of the project

13. Cost of project

14. Project implementation

15. Repayment of loans

A BP fails if ‑‑

* Estimates are incorrect
* There are no contingency provisions
* It is not realistic
* Relevant and up to date information and supporting documents are not provided.

**Terminology relevant to Business Plan preparation**

**Fixed Assets** – This refers to the assets, which are of a permanent nature having longer durability such as land, building, plant and machinery, patents etc.

**Current Assets** - include bank balance and cash and other such assets or reserves as are expected to be realized in cash or sold or consumed within a period of not more than twelve months in the ordinary course of business, such as stock-in-trade, amounts due from sundry debtors for sale of goods and for services rendered, advance tax payments and bills receivable, but does not include sums credited to a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by a company owning an industrial undertaking.

**Current Liabilities** - liabilities that must be met on demand or within a period of twelve months from the date are incurred.

**Capital Goods** – This term means any plant, machinery, equipment or accessories required by an investor for production of goods or for rendering of services, including those required for replacement of expansion

**Fixed capital:** This refers to the investment (irrespective of its sources) made on land, buildings, machinery, equipments, furniture, tools, initial stock of essential spares, vehicles etc.

**Intermediate** - the materials, which are neither in the raw form nor in the finished form. They may have potential to be converted in the finished form on further processing.

**Consumables** - items which participate or are required in a manufacturing process; but do not form a part of the end product. Items other than catalysts, which are totally consumed during the manufacturing process, are regarded as consumables. Sources of energy are not consumable. Once production commences in a factory, the available resources are utilized to get the end products or consumer goods.

**Raw Materials** - the materials, which are considered as, input materials in the raw form, required manufacturing any article, mingled/infused in the end product.

**Stocks in Process** - the materials, which are locked, ups during the process of manufacture and are not readily available for sale.

**Finished Goods** - the materials available in the finished form after processing and which can be readily available for sale.

**Outstanding Debtors** - the person or any legal entity that are indebted to pay a specific sum towards the purchase of goods to the seller.

**Working Expenses** - the expenses required for running the day-to-day affairs of the business including such expenses as wages and salaries, excise and other taxes to be paid to the competent authorities, electricity bill, utility bill, establishment expenses, etc.

**Fixed Costs**:

These are the costs, which remain constant irrespective of quantum of output within and up to the capacity that has been created/installed. (E.g. rent, insurance, etc.).

Fixed costs remain constant per unit of time. So, they decrease per unit with every increase in output and vice versa. Fixed costs are also known as `period costs'.

They can be further classified into:

(i) Committed Fixed Costs

(ii) Discretionary Fixed Costs

Committed Fixed Costs arise mainly from the possession of plant, equipment and basic infrastructural facilities. Nothing much can be done to reduce these costs without impairing the organizations' competence to meet the long-term goals.

Discretionary Fixed Costs refer to specific time/period expenses of the management. These reflect the policy of the management and have no relationship with volume of output and hence, can be reduced or eliminated, if so desired.

**Variable Costs**:

These costs are the costs, which vary, in direct proportion to output. They increase or decrease in the same proportion in which the output increases or decreases (e.g. direct material, direct labour, power, etc.).

Variable Costs may be said to be constant per unit of output.

Variable Costs are also referred to as `product costs'.

**Working capital**: Working Capital can be defined as the amount of capital perpetually locked up in the form of current assets (i.e. raw materials, work in process, finished goods, sundry debtors and cash in hand) required to sustain a specified level of activity (in terms of production and sales) under specified conditions.

**Hire Purchase** - assets acquired by paying necessary hiring charges at regular intervals in pre-determined installments. Once such installments of hiring charges are fully repaid along with the interest, the ownership of such assets is transferred to the person who had paid the hiring charges.

**Technical Know-how** - the know-how available with all the technical parameters which can help to carry out any activity including production of any article.

**Component** - means one of the parts or sub-assemblies or assemblies of which a manufactured product is made up and into which, it may be resolved and includes an accessory or attachment.

**Spares** - a part of sub-assembly or assembly for substitution that is ready to replace the original similar part, sub-assembly, if it become faulty or worn outs and includes an accessory or attachment in the same regard.

**Cost of the project:** This includes the fixed capital, working capital, payments made to acquire technology, preliminary & pre-operative expense and the value of any other tangible input that is required to commence a business

**Means of finance:** This refers to the sources of funds to meet the cost of the project. This could includes promoter’s contribution (funds invested by the promoters into the business in the form of ‘equity’), loans from financial institutions & from other sources (family for instance), grants/subsidy from the State or developmental institutions promoted by the State and shares/stocks issued to the public.

**Lease** - the assets acquired on a lease basis for which stipulated amount of lease rental at regular intervals has to be paid. The goods on lease do not offer legal ownership to the person in whose possession such goods exist.

**Technical Feasibility** - means whether with the given set of facilities, would it be possible to manufacture the end product with the quantity and quality envisaged, or not. Techno-economic Feasibility - examines the possibility of manufacturing the end-product in the pre-determined quantity with desired quality and the sale of the same results into adequate return to pay back the investment made within a reasonable period of time over the project life, with the help of the facilities installed and resources employed.

**Financial Viability** - means whether the resources employed in the implementation of the project are able to generate adequate cash to repay the cost within the reasonable time over a period of project life or not.

**Term Finance/ term loan** - the finance available for a longer duration against the fixed assets of durable nature, generally repayable over a period exceeding 36 months.

**Debt-Equity Ratio** - the ratio of debt to the equity of the project. While calculating the debt-equity ratio, the subsidy and such other sources of finance which are of a permanent nature and not required to be repaid, is considered as part of equity.

**Minimum Promoters' Contribution** - for every project, the term-lending institutions expect certain stake on the part of the promoters which is referred to as minimum promoters' contribution.

**Case study for Business Plan preparation:**

**Plastic reprocessing unit**

The business involves reprocessing or recycling of waste plastic into ‘granules’ which could then be used as raw material for manufacturing plastic products. Based on the following information, you have to prepare a business plan:

**Plant and machinery:**

Cutter for material reduction 50 kg per hour NCU 60,000 10 HP motor

Blender for mixing 85 kg per hour NCU 80,000 8 HP motor

Extruder 110 kg per hour NCU 260,000 2 kw heating load

Cooling tank 100 kg per hour NCU 40,000

Pelletiser 100 kg per hour NCU 70,000 6 HP motor

**Production process:**

Waste plastic is cleaned to remove dirt and metal parts. It is cut into small pieces in a cutter. Then, it is mixed with plasticizer (chemical) in a blender. It is then fed to a extruder where the material melts and comes out in the form of a wire so that is to cooled in the cooling tank. It is then cut into small pieces in the form of granules to be packed manually in HDPE bags of 50 kg capacity.

**Inputs:**

1. Plastic waste:

Road waste NCU 20 per kg (recovery rate of 70%)

Hospital waste NCU 35 per kg (recovery rate of 85%)

Domestic waste NCU 25 per kg (recovery rate of 75%)

1. Chemicals:

Plasticizer NCU 125 per kg (1 kg required for every 20 kg of waste)

Pigments NCU 165 per kg (1 kg required for every 280 kg of waste)

1. Packing material NCU 125 per kg (1 kg required for every 300 kg of waste)
2. Labour:

- 1 skilled operator each for extruder and blender

- Two semi-skilled for Pelletizer and cutter

- Contract labour for packing – NCU 15 per 100 kg of material packed

- Contract labour for cleaning raw materials – NCU 15 per 100 kg of material cleaned

1. Utilities:

- Power: NCU 6 per unit

- Water: NCU 6 per 1000 lts ( For Cleaning 100 kg of - waste, 10 lts water is required)

**Marketing:**

Reprocessed granules from hospital waste fetch about 10% more price where as that from road waste fetch about 3% more. The price for standard output which is an equal mixture of all types of waste is NCU55 per kg. Selling agents charge 5% commission on selling price. The transportation cost is NCU 1 per kg on an average. The selling agent pays after 30 days. However, cash payment can be received if 3% discount is offered to the agent.

Hospital waste can be procured once in 15 days directly. The procurement cost (through subcontracting) is NCU 1000 irrespective of the quantity.

Road waste can be procured once in a week through subcontracting. This costs NCU 2 per kg. Same is the case with domestic waste.

Once the order for procurement of waste is placed with the subcontractor, the lead time is 1 week.

The reprocessed granules can be sold to the selling agent once in 15 days.

The chemicals can be procured once in 15 days. There is lead time of 1 week once the order is placed. For granules made from hospital waste, any pigment (colour) can be used. But for those made form road waste or a mixture of wastes, only black pigment can be used. This pigment costs 30 % less than other colours.

All the raw materials are available locally.

**Assignment:**

* Prepare a list of assumptions you have to make
* Prepare a business plan
* Make a list of additional information required

**Chapter 8 Working Capital Management**

**1. Introduction**:

Working Capital can be defined as the amount of capital perpetually locked up in the form of current assets (i.e. raw materials, work in process, finished goods, sundry debtors and cash in hand) required to sustain a specified level of activity (in terms of production and sales) under specified conditions. The level of investment in working capital is not static and it changes continuously as a result of:

(i) Change in operating levels (in terms of production and sales) other factors remaining constant, and

(ii) Change in specified conditions like raw material prices, time for procuring raw materials, other manufacturing expenses, process time, delivery schedules, credit extended to customers, etc.

Working Capital management is the most dynamic concept of financial management in an industry. Effective working capital management would lead to:

(i) Lower investment of available finance in working capital for a given activity level

(ii) Effective management of cash and

(iii) Reduction in cost of production as a result of lowers investment of finance in working capital.

**2. Operating Cycle**

Working Capital is sometimes referred to as circulating capital. This is so because of the circulating nature of working capital.

CASH-------🡪---------------

SUNDRY RAW MATERIALS

DEBTORS

WORK-IN-PROCESS

FINISHED GOODS

The operations of any manufacturing concern can be described as an endless sequence of cycles of activity as shown in the diagram above.

The operating cycle consists of the following components:

(i) Time taken to acquire raw materials and average period of stocking

(ii) Manufacturing process time

(iii) Average period for which finished goods are stored

(iv) Average collection period of receivables.

The length of the operating cycle would be the sum of these four components. The number of operating cycles per year could be found out by dividing 365 by the number of days per operating cycle. The quantum of working capital required could be found out by dividing the expected operating expenses per year by the number of operating cycles. Effective working capital management would mean a reduction in the length of the operating cycle and consequently, a reduction in the level of working capital required for a specific level of activity.

Effective working capital management could result in a less than proportionate increase in operating expenses for given increase in level of activity.

The management of working capital has its significance for the following reasons:

(a) Cost of working capital is higher because of higher interest rate charged by bank on working capital loans than on term loans

(b) The Fixed assets are purchased occasionally and the financial decisions are called for only occasionally. But the management of current assets calls for decision making on a continuing basis and often involves huge amount of funds

(c) In an inflationary situation where prices of raw materials show a constantly rising trend, unless working capital is managed efficiently, production can be hampered for want of funds to purchase raw materials.

The aim of efficient working capital management is to see that the enterprise has sufficient funds to meet its daily expenses on production, sales and other operations and at the same time, the it does not block its capital in maintaining inventory in excess of what is required, and also that it is prompt in collecting its receivables. Blocking of excess capital means higher expenses by way of payment of interest on capital and therefore, a decrease in the profitability. An enterprise has to estimate its working capital need accurately and provide for it from its own sources or by way of outside borrowings.

Shortage of working capital could also be due to diversion of working capital funds for developmental activities, business promotion, unplanned acquisition of fixed assets, wasteful consumption, expenditure, etc. This diversion of funds would have its effect on the operating cycle, which in turn would affect the liquidity and profitability of the unit, more so in case of a small-scale unit. Thus, you must guard against such diversion of funds as it may affect the very survival of your unit.

**3. Assessment of Working Capital Requirements**

The first step towards management of working capital would be to make a realistic assessment of the working capital requirement of the unit. The process consists of making a proper assessment of the quantum of funds required to hold current assets i.e. raw materials, work-in-process, finished goods, receivables, etc. Of course, the various elements of inventory are never financed fully and there is a reduction in the form of margin to be brought in by the entrepreneur. This is to take care of the fluctuations in the market price of these elements. The total working capital granted to a unit, thus consists of two components: the finance granted by the institution and the margin brought in by the entrepreneur.

**4.Financing Working Capital**

Working Capital required is financed by one or more of the following sources:

(i) Own funds: Equity

(ii) Sundry creditors for purchases, expenses, etc.

(Credit from suppliers, etc.)

(iii) Bank borrowings

(iv) Short term/long term finance from other sources

While financing working capital requirements, an optimum mix of all the above sources of finance has to be arrived at. The idea is to lower cost of finance and at the same time, provides adequate safeguards to meet current liabilities when they fall due. Other sources of finance include profits earned and ploughed back into the business advances from customers, borrowings from friends and relatives, etc.

**5. Management of Working Capital**

The five major components of working capital are:

* Raw materials,
* Work-in-process,
* Finished goods,
* Receivables and cash.

Thus, management of working capital would mean management of the above five components. Let us now look into these components.

Raw materials:

An industrial unit needs to maintain a stock of raw materials to ensure uninterrupted production. Stocking is necessary because of uncertainties of availability, time lag between placing of order and actual delivery, sudden increase in demand, etc. Inadequate stocking could lead to stock outs which would lead to stoppage of production, inability to meet delivery schedules, cancellation of orders, etc. Thus, a balance needs to be struck between excessive stocking and risk of stock outs. Advance planning of inventory, adopting a suitable system of inventory control, and suitable procurement policy would lead to an optimum level of inventory.

Work-in-Process:

On the basis of the sales plan, suitable production plan could be drawn up so as to ensure optimum utilization of facilities, minimum inventory of work-in-process inventory and minimum amount of wastage. A suitable production planning and control system needs to be evolved.

Finished Goods:

Investment in finished goods inventory would depend on expected sales, seasonality of sales, delivery schedules, manufacturing process time, expected spurts in demand, etc. Finished goods represent both material cost and conversion charges. Hence, an unnecessary build up of inventory would be costlier as compared to other items of inventory.

Receivables:

Given the choice, every unit would prefer selling its product on cash basis. However, due to trade practices prevailing in the industry, market conditions etc., the unit is compelled to sell its goods on credit. In certain circumstances, a unit may deliberately extend credit as a strategy for increasing sales.

Receivables give rise to certain costs such as:

(i) Cost of carrying receivables.

(ii) Cost of bad debts losses.

Thus, the objective of any receivable management policy would be to ensure that the rate of growth of sales is greater than or at least equal to the rate of growth of receivables. The debtor's ratio gives us the level of receivables held by a unit at any point of time.

Receivables outstanding

Debtors' Ratio = -------------------------------------

Average credit sales per month

Each firm could determine a projected level of receivables on the basis of projected sales, past experience and factors such as type of product, type of customers, size and standing of the unit as compared to its customers, seasonality of demand, possibility of offering cash discounts, market conditions, trade practices, etc.

Once a projected level of receivables is determined, a system of monitoring would have to be evolved. The system should be evolved in such a manner that recording of information, routine follow-up and recovery could be handled by junior employees. A fortnightly, monthly or quarterly review of the level of receivables outstanding could be undertaken depending on the need of each unit.

Cash:

Investment in cash is the most unproductive form of deployment of working capital funds. However, investment in cash is essential to meet current liabilities and other cash expenses like salaries, electricity, rent etc., on time. A suitable cash budget prepared in advance would enable each unit to plan its in-flows and out-flows and thus, optimize its investment in cash. Surplus cash could be invested in marketable securities.

Thus, sound management of components of working capital as discussed above would lead to a reduction in working capital required for a specified level of activity and consequently, lead to cost saving and profitability.

**6. Significance of working capital management**

Management of working capital has its significance for the following reasons:

a) Cost of working capital is higher because of its interest rate is higher than that for term loan.

b) Fixed assets are almost a one-time purchase while management of current assets is to be done on continuous basis.

c) Unless working capital is managed efficiently, production can be hampered for want of funds.

Financing of working capital can be from promoter's own funds, sundry creditors, bank borrowings, etc.

Assessment of working capital requirements has to be done carefully and realistically for the funds required for current assets. The five major components of working capital are raw material, work-in-progress, finished goods, receivables and cash.

***Summary:***

* Working capital means capital locked up in current assets.
* Working capital management is the most dynamic concept of financial management. Effective working capital management would lead to:
* Lower investment of available finance in working capital
* Effective management of cash
* Reduction cost of production as a result of lower investment. Working capital cycle involves conversion of cash into raw material into goods in process into finished goods, outstanding and again into cash.

**Chapter 9 Break-Even Analysis: Concept and Implications**

**1. Introduction:**

As an entrepreneur on the threshold of setting up your own small unit, you will have to answer several questions centered mainly on the profitability of the enterprise that you are venturing into. In this paper an attempt has been made to find answers to some of your questions such as, how much you must produce in a year so that after covering all the costs you can still make some profit; if your plans are to install machinery that can produce, for example, 100 tons per year, what would happen in case you get the market only for 60/70 tons; if worse comes to worse, what should be your minimum production level so that you can meet all the liabilities without incurring loss and so on.

The only time you can find answers for the above questions and plan systematically for reasonable profits is at the time of establishing the unit. As you work through this paper, you will find that careful yet simple calculations can give answers to the said questions. Such calculations would lead to a figure called Break Even Point, which we will deal with in this paper.

**2. What is Break Even Analysis?**

In order to carry out profit oriented activity, may be production of goods through setting up of a factory or provision of services by setting up an automobile workshop or hotel/repair shop, certain costs are involved. Various items of costs may be the raw material cost, salaries/wages, interest charges and the money you have borrowed for setting up the unit etc. All these items of cost put together form the total cost.

The cost components can be divided into two major types viz. (i) Fixed Cost and (ii) Variable Cost.

*Fixed Costs:*

Fixed Cost is that cost which does not vary or change with other factors in the production level? In other words, there are certain items of cost such as, interest on `long term loan', rent on factory shed or office if they are rented, depreciation on machinery and building if they are owned by you etc., which are to be incurred whether your factory is working at full capacity or whether your factory is closed.

For example, if you have borrowed US $10,000 from a bank or Financial institution for buying machinery for your factory to produce 100 tons of a product per year (Product A) and the interest rate on the loan is 12.5% you will have to pay US $ 1250 an interest per year irrespective of the fact that your production is 10 tones or 15 tones or absolutely nothing.

Just to make sure that you have understood the concept of fixed cost, let us go through another illustration. Your factory building is rented and the rent per month is US $ 1000. The production of monthly basis is 500 units in January, 800 in February and 600 in March. Now, the question is what is the fixed cost for your factory as such for the months of January, February and March? Likewise, what is the fixed cost per unit of the output in these months?

The fixed cost for the factory unit as such, assuming that there are no other costs, would be US $ 1000 per month for each of these 3 months. The fixed cost per unit of the output can be obtained by dividing fixed cost for a month by the number of units produced/to be produced for that month as noted below:

Month Fixed Cost/ No.of Units Fixed Cost /Unit of Output

January 1000/500 US $.2.00

February 1000/800 US $.1.25

March 1000/600 US $.1.66

Another interesting point you will note from the above example is that though the total fixed cost for the factory as such remains constant (i.e. US $1000 per month), there is an increase fixed cost per unit of the output when the production decreases and likewise, there is a decrease in the fixed cost per unit when the production increases.

*Variable Costs*

Variable Cost is variable with the level of production i.e. variable cost is directly related to the quantity of output. For example, if you need US $ 100 worth as raw materials to produce 1 ton of Products A, the variable cost can be calculated as below:

Raw material cost per ton of output i.e.

Variable Cost per ton = US $100

Month Output Variable Cost

January 500 Kgs. US $ 50,000/

February 800 Kgs. US $ 80,000/

March 600 Kgs. US $ 60,000/

As you will see from the above illustration, that the total variable cost for your business as a whole increases/decreases along with the increase/decrease in production level. But the variable cost remains constant for every unit of output.

In short, any item of cost, which does not change, with the level of production is `fixed cost' and that item of cost which changes with the level of production is `variable cost'. Fixed cost is fixed for your factory as such. But fixed cost per unit of the output varies with change in production level. Variable cost for the factory as such is variable as per the production level. But variable cost per unit of output may remain constant.

When we make an attempt to classify various items of cost into fixed and variable cost we may come across certain items of costs such as, wages which remain fixed till you reach a particular level of production but vary whenever that level is crossed. In other words, there are certain items of cost, which can be termed as `semi variable'. But for operational convenience, it is sufficient if you could classify the cost components into Fixed and Variable without going into further analysis.

Having understood the level of Fixed Cost and Variable Cost, lets us know see how best we can understand the concept of Break Even Point.

**3. Calculating the Break Even:**

Whenever you calculate profit for your project at the time of preparing the project report or making projections for the coming year (when your unit is already in operation), you normally deduct Total Cost from Total Sales Revenue to arrive at Gross Profit.

Suppose, you go a step further and calculate profit at two stages by splitting the Total Cost into Fixed Cost and Variable Cost for the project, the analysis will throw some light. You know that Variable Cost per unit of the output remains the same. Hence, given the same selling price, the difference between Variable Cost per unit and selling price per unit, which we call `Contribution' also, remains the same. Thus, as sales go up, the Contribution (difference between Sales Revenue per unit and Variable Cost per unit x No. Of units) also goes up. Given the fact that the Fixed Cost for the project remains the same, you have to at least earn enough money to meet the Fixed Cost. In other words, if you do not want to incur loss, you must sell enough number of units of the output so that the contribution is equal to the Fixed Cost. Your Profit would be to the extent of the Contribution, which is in excess of Fixed Cost.

Such a 2-stage analysis to identify the production level at which you make neither profit nor loss is called Break Even Analysis. The said production level is called Break Even Point.

We can now put it mathematically as below:

i) Total cost of production for `X' units = Variable Cost for `X' No. Of Units (VC) + Total Fixed Cost

ii) Contribution (CN) = Sales Revenue (SR) - Variable Cost (VC)

1. Profit (P) at `X' level of production = (Sales Revenue for `X' No. of Units)- Total Cost.

i.e. SR- (VC + FC) or SR-VC-FC

i.e. Profit = Contribution (SR-VC)- Fixed Cost (FC)

To clarify the concept, let us now look at the illustration mentioned below. The calculations are done at 3 different production levels to illustrate the relation between the level of production and profit.

Selling Price per unit US $ 10.00

Variable Cost per unit US $ 4.00

Fixed Cost for the Project US $ 90,000

Production Levels 10,000 15,000 20,000

Units Units Units

Sales Revenue 100,000 150,000 200,000

Variable Cost 40,000 60,000 80,000

Contribution 60.000 90,000 120,000

This income - `Contribution' - is not profit, as we have to meet Fixed Cost also. Considering the Fixed Cost for the Project is US $ 90,000 then at 10,000 units' production level, the company is incurring a net loss of US $ 30,000. In other words your contribution is unable to meet fixed cost entirely. (US $ 60,000 < US $ 90,000); at 15,000 units production level, there is no profit or loss (US $ 90,000 =90,000) and at 20,000 units production level, a net profit of US $ 30,000 (US $ 120,000 - US $ 90,000) is made.

Thus, Profit = Contribution (CN)-Fixed Cost (FC). At 15,000 unit's production level, the company is just breaking even and so, it is called Break Even Point (BEP) of production. At this level, the Contribution = Fixed Cost i.e. CN = FC.

BEP can be expressed either in terms of number of units that you have to produce to reach `No profit No Loss Level' or in terms of sales revenue.

3.1 Capacity Utilization Indicator

Usually Break Even Point is expressed in terms of capacity utilization. In other words, suppose your factory can produce a maximum of 100 tones of Product A per year which we can call the installed capacity, at what percentage of installed capacity you must operate to reach the Break Even level of production? This could be found out using the below noted formula:

FC

BEP = --------------- x 100 = .....%

SR - VC

Where, BEP= Break Even Production Level in terms of percentage.

FC = Fixed Cost per year in

VC = Variable Cost during that year.

SR = Sales Revenue during that year.

3.2 Sales Revenue Indicator

Break Even Point in terms of Sales Revenue could be calculated using just two figures viz., fixed Cost and `Profit Volume Ratio'. One of the important ratios to watch in business, especially in Break Even Analysis is P/V Ratio. It expresses the relation between `Contribution' (Sales Revenue- Variable Cost) and Sales. This indicates the percentage of Contribution in relation to the volume of sales. In other words, it tells you that after meeting Variable Cost, what percentage of sales revenue is available to you to meet fixed cost and then, earns profit.

Thus, P/V Ratio = Contribution

Sales

Sales-VC SR-VC

= ------------- = ----------

Sales SR

Suppose, the Sales Revenue per year is US $ 4,000 and the variable cost is US $2000, then the P/V Ratio is calculated as under:

P/V Ratio = Contribution/Sales = (SR-VC)/SR

4000 - 2000

------------- = 1/2 = 0.5

4000

In other words 0.5 or 1/2% of your Sales Revenue is available to meet fixed cost.

Having understood the concept of P/V Ratio, we can now see how to calculate Break

Even Sales Revenue using the below noted Formula:

Break Even Sales Revenue = Fixed Cost = FC

P/V Ratio (SR- VC)/SR

Practice the Illustration

With the help of illustration, let us now find out how these formulae can be applied. Let us take the example of a unit manufacturing a chemical product. The below noted illustration gives details of all costs so that we can practice identifying fixed cost as well as variable costs. Before you go through this illustration, please make sure that you have understood the terminology and concepts discussed so far.

I. Cost of the Project

i) Land US $ 10,000

ii) Building US $ 99,000

iii) Machinery US $ 101,100

iv) Working Capital US $ 91,500

v) Preliminary preoperative exp. US $ 5,000

Total US $ 306,600

II. Means of Financing

i) Long term loan US $ 157,000

ii) Working Capital loan from Bank US $ 64,000

iii) Capital Subsidy US $ 31,000

iv) Own Contribution US $ 54,600

Total US $ 306,600

III. Cost of Production

i) Raw material US $. 846,000

ii) Power US $ 7,500

iii) Fuel US $ 25,000

iv) Wages US $. 62,000

v) Stores and Spares US $ 6,000

vi) Maintenance US $ 6,000

vii) Insurance US $ 5,000

viii) Miscellaneous US $ 5,000

ix) Administrative Expenses US $ 8,000

x) Selling Expenses US $ 65,000

xi) a) Interest on Term Loa

@12.5% on US $157,000 US $ 19,600

b) Interest on Working Capital

Loan @14% on US $64,000 US $ 9,000

xii) Depreciation figures are Approx.

a) On Building @5% of 99,000 US $ 5,000

b) On Machinery @15% of 101,100 US $ 15,000

Total US $1,084,100

SAY US $1,084,000

===========

IV. Other Information

i) Installed Capacity = 1500 kgs. per year on single shift basis

ii) Operating Capacity = 100% (for calculations purposes)

iii) Sales Quantity = 1500 kgs valued at US $ 850/ per kg.

= US $ 1,275,000

iv) Profit (Sales = US $ 1,275,000 - US $ 1,084,000

Revenue - Total Cost = US $ 191,000

From the data in the said illustration, we have to do the Break Even Analysis. The first step for doing so is to segregate the cost components into Fixed and Variable Costs. You will notice that there are certain items like maintenance cost; cost of spares and stores; administrative expenses etc. that are neither Fixed nor Variable i.e. they can be classified as Semi variable cost.

Right now, we will not go into this sort of analysis. In case we have to identify Semi Variable Cost properly and accurately, we have to examine the given cost item and if it is found that it is semi variable in nature, split the cost items into variable sub components and find out which one is Fixed and which one is variable. What we will now do for the sake of simplicity in calculation is to divide the cost components into just two parts viz., Fixed and Variable cost. If it is found that a particular item cannot be so classified and falls under the category of semi variable cost, we may take 50% of that item in Fixed Cost and rest in Variable Cost. However, in practice, it is advisable to categories the cost properly and in case of semi variable costs takes that component which is fixed, under the title `Fixed Cost'. The items of cost as they appear in the said illustration can be categorized as follows:

Item Variable Cost Fixed Cost

1. Raw Material US $ 846,000

2. Power US $ 7,500

3. Fuel US $ 25,000

4. Wages US $ 62,000

5. Stores & Spares US $ 6,000

6. Maintenance \* US $ 3,000 US $ 3,000

7. Insurance US $ 5,000

8. Miscellaneous\* US $ 2,500 US $ 2,500

9. Administrative Expenses\* US $ 4,000 US $ 4,000

10. Selling Expenses US $ 65,000

11. Interest on Term Loan US $ 19,600

12. Interest on Working Capital US $ 9,000

13. Depreciation on Bldg.& M/c. US $ 20,000

Total US $ 988,000 US $ 96,100

You will notice that 3 items of cost marked\* are semi variables and for simplicity in calculation 50% of the amount has been taken as Fixed Cost and Cost rest as Variable Cost. For example, in this case, wages are taken as Fixed Cost because the job calls for skill and skilled labour cannot be thrown out just because the production goes down from 1500 Kgs. to 1200 Kgs. or so per year. So, the categorization indicated above cannot and should not be considered as universally applicable.

As you will see from the above statement total Fixed Cost is US $ 96,000 (approx.) and Variable Cost is US $ 988,000.

As a check, when you add both the figures, the sum total must be equal to the total cost as it appears in Serial No.III above. Now, with the following data, let us do the necessary calculation using the methodology described above.

Fixed Cost (FC) = US $ 96,100

Variable Cost (VC) = US $ 988,000

Selling Price (SP) = US $ 850 per kg

Production at full capacity = 1,500 Kg per year

Sales Revenue (SR) = US $ 1,275,000

i) Break Even Production Level = FC/Contribution x 1000

Contribution = SR- VC = US $ 1,275,000 less

US $ 988,000

= US $ 287,000

Break Even Production Level

96,100

= --------------- x 100

287,000

= 33.48%

This means that when the production reaches 33.48% of the installed capacity (full capacity) your factory will reach the level where you neither make profit or loss.

Let us now see how to check the calculation:

Installed Capacity = 1500 Kgs. per year

Break Even Point = 33.48%

Therefore, Production Level = 1500 x 33.48

--------------- = 502.2 Kgs.

100

We noted that the contribution is US $ 287,000

Contribution per Kg. of output = US $ 287,000

---------------- = US $ 191.33

1500

It means that for every Kg. of output you earn US $191.33 to cover the fixed cost. Now, a Break-Even Production level of 502.2 Kgs., the contribution is 502.2 x 191.33.

= US $96,086

SAY = US $96,100

This means that a Break Even production level of 502.2 Kgs. after covering all variable costs, you will be left with US $ 96,100 to cover the Fixed Cost.

By now, you would have already realized that the calculations are right. However, let us see the below noted calculation.

Profit = SR-VC-FC = Contribution-FC

At a production level, of 502 Kgs., profit = US $96,100 - US $96,100 = US $ 0

ii) Let us now try to calculate the Break Even Sales Revenue:

FC

Break Even Sales = ----------------------

P/V Ratio

Contribution SR-VC

P/V Ratio = ------------------------- = -------------

Sales SR

= 1,275,000 - 988,000

----------------------------= 0.225

1,275,000

Break Even Sales Revenue = 96,100

------------ = 426,700 ( Aprox.)

0.225

Thus, if your Sales Revenue reaches the level of US $ 426,700 then you will neither make profit nor loss? This calculation can be checked for its accuracy like the one we did to calculate the Break Even production level. However, if you have understood the concepts of Break Even Point and P/V Ratio discussed so far, you should be in a position to check the calculation yourself. Why don't you do that?

**4. Application of Break Even Analysis:**

So far, we have understood the concepts of BEP and calculation involved in Break-Even Analysis (BEA). We now see how we can use this concept for decision making:

i) At the outset, BEA helps you in taking investment decisions. Projects with high break-even Production level tend to be risky in the sense that high Fixed Cost can make the project easily susceptible to even a slight drop in sales revenue either due to low selling price or low sales volume.

ii) In case you are producing or planning to produce more than you must produce to optimize the profit.

iii) In case you have a multi product unit or even a single product unit and you have to increase your production to meet the demand, BEA helps you in `make or buy' decisions, i.e. whether you should increase the production in your factory by employing more resources or whether you should subcontract the work or buy the product from someone and sell it.

iv) BEA is a convenient tool for product pricing. It helps you decide how much should be the ex-factory price of your product. It also helps you in deciding whether you should allow any discount on bulk purchase and if so, how much should be the discount. Likewise, you can decide what price to quote when you participate in a big tender.

v) BEA makes certain calculations about profitability at various levels of production. We will now see how BEA can be applied in some areas. For calculation purpose, we will use the illustration of the chemical unit described earlier.

*Summary:*

As a new entrepreneur, you would, before you establish your unit, like to know whether you can sell what you produce and how much you should produce so that you can meet all your liabilities, and make profits.

Costs are involved in carrying out production activities and all the items of cost involved put together form total cost. The cost components can be divided into:

1. Fixed cost is that cost which does not vary or change with change in the production level? E.g., interest on term loan, rent of factory, depreciation on machinery, etc.

2. Variable cost is variable with the level of production, e.g. cost of raw material, wages, fuel, royalty, etc.

Break Even Point (BEP) is a level of capacity utilization at which you make neither profit nor loss. If you produce and sell at a point higher than the BEP, you make profit.

For example, if your break even level of capacity utilization is 60%, it means that unless you reach the 60% level, you will continue to make a loss, and if your utilization goes beyond that, you make profit.

Break Even Analysis is one of the most important tools for an entrepreneur at the stage of project planning and more so, during the course of managing the unit. As you have seen in this note, BEA can help you in deciding production level apart from helping you to take decisions regarding tender, quantity discount, pricing etc. You should not forget that production is not an independent factor to be planned separately based only on BEA. Market, demand, availability of raw material, finance etc. do have implications on production planning. This does not undermine the importance of BEA. Market competition may often force you to cut prices. Thus, to decide on production level or pricing or any such issue, various factors, which affect such decisions, are to be taken into account. Given such complex conditions, BEA is an aid to arrive at a final decision

**Breakeven analysis**

Practice the Illustration

With the help of illustration, let us now find out how these formulae can be applied. Let us take the example of a unit manufacturing a chemical product. The below noted illustration gives details of all costs so that we can practice identifying fixed cost as well as variable costs. Before you go through this illustration, please make sure that you have understood the terminology and concepts discussed so far.

I. Cost of the Project

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v) Preliminary preoperative exp. US $ 5,000

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x) Selling Expenses US$ 65,000

xi) a) Interest on Term Loan

@12.5% on US $157,000 US $ 19,600

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xii) Depreciation figures are Approx.

a) On Building @5% of 99,000 US$ 5,000

b) On Machinery @15% of 101,100 US$ 15,000

Total US$ 1,084,100

Say, US$ 1,084,000

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IV. Other Information

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ii) Operating Capacity = 100% (for calculations purposes)

iii) Sales Quantity = 1500 kgs valued at US $ 850/ per kg.

= US $ 1,275,000

iv) Profit (Sales = US $ 1,275,000 - US $ 1,084,000

Revenue- Total Cost = US $ 191,000

**Chapter 10 Financial Accounting and Statements**

**1. Introduction:**

Any business activity, be it manufacturing, servicing or trading, involves monetary transactions. At the end, if the total money received is more than the total money spent, the business is said to have generated a ‘surplus’ or `profit'. If it is otherwise, the business is said have been in ‘deficit' or ‘loss'. Every business intends to generate a surplus or profit. Therefore, the promoter(s) is/are always interested in knowing the outcome of the economic activity.

Several transactions take place in the course of business. To remember all of them is almost impossible. A business therefore, needs to record all such transactions to find out the outcome of the business activity. A methodical and systematic science has been developed which helps the promoter to record all economic transactions properly and know the outcome of the business dealings. This science is called "Financial Accounting."

Accounting is a name given to the system which measures records, analyses and reports the effect of business transactions and events taking place in business enterprises. Since such reporting is in financial units, the system is also known as financial accounting. It has been defined as the art and science of recording business transactions in a methodical manner so as to show (a) the true state of affairs of a business at a particular time, and (b) the surplus or deficiency, which has accrued during a specified period.

Thus `Financial Accounting' involves (a) data recording and (b) data presenting technique used for recording various transactions. This is called Bookkeeping. The data recorded is summarized and systematically arranged and presented to various users in the form of Financial Statements.

**2. Accounting Terminology:**

It is advisable that you get acquainted with the accounting terminology. It would help in understanding the accounting process and preparation of the financial statements.

Business

Business is a generic term including any activity undertaken for the purpose of making profit. It can include manufacturing, trading or service activity, etc.

Accounting Equation

It means that in mathematical terms total assets of a business are always equal to the aggregate of its liabilities and capital. That is

Total Assets = Total liabilities + capital assets

The term `assets' refers to properties that can be expressed in terms of money, e.g. plant and machinery, vehicles, stocks, cash etc. It also includes money due to the business from debtors for goods and services etc.

Liabilities

Liabilities are all financial obligations of the enterprise except the owner's funds.

Capital

This is the amount invested in the business by the owner and includes profits of the business to the extent they are not withdrawn by the owner for his/her personal use.

Drawings

The value of goods or cash withdrawn by the owner for personal use.

Debtors or Accounts Receivable

Means amount due from customers for goods / services supplied to them.

Creditors or Accounts Payable

Amount due by the business to its suppliers for goods / services supplied by them to the business.

Capital Expenditures

Expenses incurred to acquire fixed assets like; land, building, plant, machinery, vehicles etc.

Revenue Expenditure

Expenses such as salaries, wages, power, fuel, stationery, office expenses etc.

Capital and Revenue Receipts

Here the important factors guiding the classification are as follows:

If the receipt is commercial in nature, it is revenue, but if it is received as a result of parting with some property, it is a capital receipt.

If a receipt is on account of current assets, it is a revenue receipt and if it is on account of fixed assets, it is a capital receipt.

Transactions

In business there are two types of transactions

i) Cash transactions

ii) Credit transactions

Cash transactions result in exchange of cash while credit transaction result into an obligation to pay/receive cash in future.

Accounts

Transactions involve `Accounts'. Each transaction is done through `accounts' only. There are three types of accounts:

1] Personal or individual accounts

This group of accounts includes all accounts of individuals, firms, companies, societies etc.

2] Asset Accounts or Real Accounts

These cover accounts of all types of assets. Here assets mean all those investments made in tangible or intangible assets which have utility value and which can also be converted into cash.

3] Nominal Accounts

These accounts represent the revenue income and revenue expenditure of the business.

**3. What is bookkeeping?**

‘Bookkeeping' is one of the functions of financial accounting. Bookkeeping entails maintaining proper records and books for recording complete details of transactions made during the course of business. Business transactions can be classified into several major activities/groups e.g. sales, purchases, assets, etc. Separate books for recording transactions pertaining to these activities are maintained, registering in them the details of respective transaction. This exercise is called Bookkeeping.

**4. Why are Books of Accounts Maintained?**

It is extremely important to have latest information about what is happening in the business. This helps in taking appropriate and timely action. A doctor needs details about the physiological conditions of a patient to diagnose the illness, its causes and its remedies. Just like that the owner of the business, creditor, or banker needs to know about the latest financial health of the business for taking suitable decisions about the future course of action. Bookkeeping helps in maintaining and providing the latest position of the business and, therefore, assumes great significance. It is advisable to maintain books of accounts for the following reasons as well:

* They provide up-to-date information about the business.
* They reflect the outcome of transactions made during the period under review.
* They give information about the state of affairs of the business at regular intervals.
* They help governments and other authorities to decide about the incidence of various taxes.
* They help analyze the performance of the business.
* They help compare the performance of several business firms.

The accounting information of business is required not only by the owner of the business but by various other parties too. They are the government, suppliers, creditors, bankers, investors, shareholders, auditors, etc. They depend on the information prepared by financial accounting for taking various decisions pertaining to their activities. This emphasizes the need for writing books of accounts in a systematic and methodical way. Though, as an owner of the business you have the prime responsibility to write and maintain the books of accounts, you are not free to write the accounts, the way you like. You have to write the accounts as per the norms and principles of techniques and systems of accounting used the world over. There are a few accounting techniques available for writing accounts but the Double Entry Bookkeeping System has universal acceptability and credibility. It is the modern and scientific accounting system designed to reflect the true and fair position of the business.

**5. Double entry bookkeeping:**

The concept of the Double Entry Bookkeeping System is based on the principle that every economic transaction has two effects, which are exactly opposite to each other. Any transaction can have only two effects: `debit' and `credit', and they are always equal. As a result, at the end of the accounting period, the accounts should `tally', meaning thereby that both `total debits’ and `total credits' should tally with each other. Double entry bookkeeping is designed in such a way that, while entering the credit entry of a particular transaction, the details of the corresponding debit entry is also given.

**6. Writing accounts under double entry bookkeeping**

6.1 Transactions:

In business, the promoter does several transactions. The effect of these transactions on the business is recorded in the books of accounts. Only those transactions, which result in exchange of money or exchange of goods or services, whose value can be measured in monetary terms, need accounting treatment. Transactions may be of the following nature:

(a) Exchange of goods against cash / credit

(b) Exchange of services against cash / credit

(c) Exchange of assets against cash / credit

(d) Payment of cash to creditors

(e) Receipt of cash from debtors

(f) Exchange of goods against assets

(g) Exchange of goods against services

Thus several types of transactions take place in business and they form the starting point of accounting. There are two types of transactions: (i) Cash transactions and (ii) Credit transactions. Cash transaction results in exchange of cash, while credit transaction results in an obligation to pay / receive cash in the future.

6.2 Accounts:

Transactions involve `accounts'. Each transaction is done through an `account' only. There are total three types of accounts:

(i) Personal account or Individual account: This group of account includes all accounts of individuals and organizations like a firm, a corporate entity, a society, etc.

(ii) Assets account: This group of accounts covers all types of assets. Assets mean all those investments made in tangible or intangible form of assets, which have utility value or use value. Moreover, these assets can also be disinvested and converted into cash.

(iii) Income-expenditure account: This group of accounts encompasses all accounts, which represent revenue income and revenue expenditure of the business.

6.3 Rules of Debit and Credit:

In the Double Entry Book-Keeping System, each transaction has two effects. One is called `Debit' and the other is called `Credit'. Thus each transaction has minimum one debit effect and minimum one corresponding credit effect. There are prescribed rules for debiting and crediting various accounts, which are classified under three major groups as mentioned above. These rules form the basis of accounting under Double Entry Bookkeeping System. Below given are these rules:

(i) Rule for ‘Personal Accounts’: "Debit the Receiver and Credit the Giver".

*Explanation:* Any person involved in a transaction can either be a receiver of cash, asset or services, or be a giver of cash, asset or services, without any immediate consideration. The account of the person who receives is debited, while the account of the person who gives is credited.

(ii) Rule for ‘Assets Accounts’: "Debit what comes in and Credit what goes out."

*Explanation:* In business, goods and assets come and go. Whenever assets or goods come in the business its respective account is debited, while in the case of assets or goods going out of the business as a result of a transaction, its respective account is credited.

(iii) Rule for `Income-Expenditure Accounts’: "Debit Expenses and Losses and Credit Incomes and Gains***"***

*Explanation:* This group of accounts covers all revenue income and expenditure accounts. All those revenue incomes that are generated during the course of the business are credited in their respective accounts and all such revenue expenditures incurred during the course of the business are debited in their respective accounts.

6.4 Steps for Identifying Debit or Credit Effect

(i) Decide whether the transaction needs accounting treatment.

(ii) Determine which are the two accounts involved in the transaction.

(iii) Apply the rules of debit and credit for the identified accounts as per their classification.

(iv) It should be seen that there couldn’t be both ‘credits’ and both ‘debits’ in a single transaction. Every transaction must have a debit and a corresponding credit.

The Journal Entry

A journal entry is the first noting in the books of accounts whereby debit and credit effects of each transaction on accounts are identified and noted along with proper description. Journal entries help in preparing several books of accounts. A suggestive format for maintaining a journal and writing journal entries is shown below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Journal entries in the book of M/s ................. | | | | |
| Date | Particulars | Ledger  Folio No. | Debit  (Amount) | Credit  (Amount) |
|  |  |  |  |  |

*Explanation:*

Date: The journal entries must be written date-wise in a chronological sequence. It is ideal to make entries of the transactions daily. The year, month and date of the transaction for which journal entry is made should be mentioned in the `Date' column.

Particulars: In this column, for each transaction, the account to be debited and the account to be credited is mentioned. The account, which is to be debited, is written first followed by the account to be credited. A word 'To' precedes the name of account, which is credited.

E.g. "Bank account debited to sales account"

Subsequent to debiting and crediting the appropriate accounts, a brief narration of the transaction, if possible, in one line only is written in the ‘Particulars’ column.

Ledger Folio No.: In the third column the folio number of the respective accounts in the ledger is mentioned. This helps trace the posting of each transaction and verify it.

Debit and Credit: In this column the amount by which the respective account is debited and credited is mentioned. At the end of every page the total of debits and credits is made and is carried forward to the next page.

Ledger

A ledger is a book, which contains details of all accounts in which transactions are made. It contains a condensed and classified record of all business transactions transferred from the journal or subsidiary books. Ledger is the principal book under the double entry bookkeeping system. It contains up-to-date information about all accounts, e.g. if an owner wants to know how much he/she owes to Mr. X, he/she can learn this from Mr. X’s account maintained in the Ledger. If such accounts were not maintained in the ledger, the owner would be required to go through each transaction involving Mr. X to find out the payment liability. This exercise is time-consuming and inconvenient. For businesses with a sizeable number of transactions, it is impossible to scan the primary books or journal every time to know the exact position of any account. It is, therefore, very important to maintain a ledger.

A suggestive format for maintaining an ‘account’ in the ledger is given below:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Debit Side Account (Name of the account) Credit Side | | | | | | | |
| Date | Particulars | Folio No. | Amount | Date | Particulars | Folio No. | Amount |
|  |  |  |  |  |  |  |  |

*Explanation:*

It may be noticed from the format that a ledger account has two sides: debit side (left-hand side) and credit side (right-hand side). Each side is further divided into four sections, viz. `Date', `Particulars', `Journal Folio Number' and `Amount'.

(i) Date: In this column, the date of a transaction as entered in the journal book from where the entry is brought to the ledger account is mentioned.

(ii) Particulars: In this column the name of the account in which the corresponding credit or debit (under the double entry principle) is found, is mentioned.

(iii) Journal Folio Number: In this column the page number of the journal book or subsidiary book from where the transaction is brought to the account is mentioned.

(iv) Amount: In this column the amount, with which the account is debited or credited, is mentioned.

Transactions

Transactions are entered, as and when they occur in the journal book or subsidiary books. From there necessary records are created in the ledger. The process of transferring entries from the journal or subsidiary books to the appropriate accounts in the ledger is called `posting'. If an account is debited with an amount as entered in the debit column of the journal book, the same is posted to the debit side of the account in the ledger. Similarly, if an account is credited in the journal book, it is posted to the credit side of the account. While posting entries, care should be taken to see that the name of the account in which the entry is posted is not mentioned in the column of particulars. Instead the name of the other account, which is affected under the same transaction, should be mentioned. While posting, each entry to the debit side of an account should begin with the word `To' (in the `particulars’ column) and each entry to the credit side should begin with the word `By'.

**7. Balancing the Account:**

Normally as it happens, the total of all postings to the debit side and the credit side of the account is not equal. The amount by which the total of any side (debit or credit) is greater than the total of the other side is called the `balance' of the account. If the total of debit side is greater then the balance is called `debit balance' and if it is vice versa, it is called ‘credit balance.' For example

i) Following accounts always have debit balances:

a) Cash account / Bank Account

b) Asset’s account

c) Debtor’s account

d) Stocks account

e) Revenue expenses account

f) Losses account

g) Investment account

ii) Following accounts always have credit balances:

a) Creditor’s account

b) Revenue income's account

c) Gain’s or profit's account

d) Bank loan account

e) Interest received

As seen earlier, the journal book is the first book required to be kept in the business where all transactions are recorded. It is the book of original entry. Likewise, the ledger is the most important basic book, which records all accounts. So long as the transactions in the business are limited and simple, it is possible to enter all transactions first in the journal book and then in respective accounts in the ledger. But with the size of a business and the number of transactions increasing, it becomes difficult to maintain a journal book for all the transactions and post them in the ledger. Under such circumstances, it becomes necessary to divide the journal books and the ledger into some separate subsidiary books, each of which is reserved for recording one particular class of transactions, e.g. purchase book, sales book, cash book, etc.

**8. Books needed to be maintained for a Simple Accounting System:**

For a small industrial enterprise, the usage of the simple financial accounting system is recommended. Such businesses must maintain a set of books as suggested below. By doing so, the businesses can get a correct and fair picture of the activities speedily.

(a) Journal: All transactions (except those which are to be recorded in subsidiary books) are properly recorded here.

(b) Subsidiary books (for journal)

(i) Purchase book: In the purchase book, all transactions pertaining to purchases, be it on credit or by cash, are recorded. Transactions of purchase returned are also recorded here separately.

(ii) Sales book: In the sales book, all transactions pertaining to credit or cash sales are recorded. Transactions of sales returned are also recorded separately.

(iii) Ledger: All accounts involved in the transactions recorded in the journal or its subsidiary books are maintained here, and necessary posting is made.

(iv) Cash book: The cashbook is a subsidiary book of the ledger where the account of `cash' is maintained. Transactions involving ‘petty cash’ are also posted here separately.

(v) Bank book: The bankbook is a subsidiary book of the ledger where the account of `bank' is maintained.

(vi) Stock register: This is a register where the movement of stock is maintained.

The formats for the journal book and the ledger accounts were discussed earlier. The formats of subsidiary books like purchase book, sales book, cashbook, bankbook and stock register are given here along with a brief explanation for its usage.

##### Format of a Purchase Book

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Party’s Name | Bill No. | Ledger Folio | Item Name | Quantity | Rate | Amount | Terms |
|  |  |  |  |  |  |  |  |  |
|  | Total |  |  |  |  |  |  |  |

*Explanation:*

(i) Date: The date on which the purchase was made is mentioned here.

(ii) Particulars: The name of supplier of the materials and necessary details of the invoice are mentioned here.

(iii) Bill No.: The number of the bill of the supplier is mentioned here.

(iv) Ledger Folio: The folio number of the ledger, on which either the supplier's account (if credit purchase) or cash account (if cash purchase) is credited, is mentioned here.

(v) Amount: The net amount of purchase made is mentioned here.

(vi) Terms: The terms of purchase, as on cash terms or credit terms, etc., are mentioned here.

**Format of a Sales Book**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Party’s Name | Bill No. | Ledger Folio | Item Name | Quantity | Rate | Amount | Terms |
|  |  |  |  |  |  |  |  |  |
|  | Total |  |  |  |  |  |  |  |

*Explanation:*

(i) Date: Date on which the sales transaction took place is mentioned here.

(ii) Particulars: The name of the purchaser of the goods and necessary details of the transaction are mentioned here.

(iii) Bill No.: The number of the bill given to the buyer is mentioned here.

(iv) Ledger folio: The folio number of the ledger on which either the buyer account (if credit sales) or cash account (if cash sales) is debited is mentioned here.

(v) Amount: The amount of sales done through this transaction is mentioned here.

(vi) Terms: The terms of sales transactions like, ‘cash or credit’ is mentioned here.

**Format of a Cash Book**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Debit side Credit side  (Receipts) (Payments) | | | | | | | |
| Date | Particulars | Journal Folio | Amount | Date | Particulars | Journal Folio | Amount |
|  |  |  |  |  | Closing balance |  |  |
|  | Total |  |  |  | Total |  |  |

*Explanation:*

The ‘Cash Book’ is nothing but a cash account. Like other asset accounts, this account is also required to be mentioned in the ledger. However, because of the multiplicity of cash transactions and for convenience, cash account is not maintained in the general ledger but maintained as a separate account and named as cash book. All the rules of maintaining accounts in ledger apply to this account also.

**Format of a Bank Book**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Debit side Credit side  (Deposition) (Withdrawals) | | | | | | | |
| Date | Particulars | Journal Folio | Amount | Date | Particulars | Journal Folio | Amount |
|  |  |  |  |  | Closing balance |  |  |
|  | Total |  |  |  | Total |  |  |

*Explanation:*

Like cash book, bank book is nothing but bank account required to be maintained in ledger. Since the transactions involving bank are increasing, it is convenient and proper to keep a separate bank account where all transactions involving bank are posted. This account, therefore, is separately maintained and named bank book. All rules of making posting in other ledger accounts are applicable to this account as well.

**Format of Stock Register**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Date | Particulars | S.B./P.B. Folio No. | Receipts | | Issues | | Balance | |
| Quantity | Value | Quantity | Value | Quantity | Value |
|  |  |  |  |  |  |  |  |  |

*Explanation:*

The stock register is very similar to stock account. It tells us about the actual closing stock available with the business to help the owner physically verify and place further orders.

(i) Date: The date of transactions resulting in movement of stock is put here.

(ii) Particulars: The details of transactions due to which the stock changes, are narrated here.

(iii) Sales book/purchase book folio number: The page number of the sales book or purchase book where the particular transaction resulting in addition or deduction of stock is put here.

(iv) Addition: Purchase resulting in addition of stock. The quantity of stock purchased along with its value is put here.

(v) Deduction: Sales result into deduction of stock. The quality of stocks sold along with its value is put here.

(vi) The closing balance: The amount that accrues, as a result of addition or deduction is calculated and put here.

(vii) Item wise separate page is to be kept in Stock Register.

**9. Financial Statements:**

Financial statements are a collection of data organized according to a logical and a consistently defined accounting procedure. The statements serve as a useful indicator of a firm’s financial position.

Normally at the end of the financial period for which the accounts are written, the ledger accounts are closed and balances are drawn for the purpose of preparing final accounts. The statements which are needed for final accounts are:

* Trial Balance.
* Profit and Loss Account.
* Balance Sheet.

**9.1Trial Balance:**

The first step in the process of preparing final accounts is to prepare a Trial Balance. The main objective of Trial Balance is to determine the arithmetic accuracy of the entries made in the ledger.

The fundamental principle of double entry book keeping is that every transaction has a debit and a corresponding credit effect. It means that the total of all accounts, which have a ‘Debit Balance’, and the total of all those accounts, which have a ‘Credit Balance’, at the end of the accounting period, should tally. They should be equal; otherwise the accounts would be inaccurate. This is where the trial balance features.

While preparing the Trial Balance, the accounts that have debit balance are placed in the debit column, while the accounts which have credit balance are placed in the credit balance. The total of debit entries must tally with the total of credit entries unless some mistakes in posting, or compilation have been committed. One has to understand that the agreement of the total of debit and credit column of the trial balance ensures only arithmetical accuracy of accounting and is not conclusive evidence to prove accounting accuracy as there are some mistakes which a Trial Balance cannot detect.

**Format of a Trial Balance**

Trial balance of M/s \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ for the Year \_\_\_\_\_\_\_\_

|  |  |  |  |
| --- | --- | --- | --- |
| Ledger Folio | Name of Account | Debit Amount | Credit Amount |
|  |  |  |  |
|  | Total |  |  |

9.1.1 Explanation:

1. Ledger Folio: The folio number (page number) of the ledger or its subsidiary books where a particular account is maintained is returned in this column. It helps in cross checking the accuracy of accounts.

2. Name of Accounts: The name of the account whose closing balance is being brought to the Trial Balance is recorded here.

3. Debit & Credit: The amount of debit and credit balance of the individual account is mentioned here. It may be noted that a single account at a time cannot have both debit and credit balances. An account can have any of it, either credit or debit closing balance.

4. Total: When the closing balance of all accounts from the ledger and its subsidiary books are brought to the Trial Balance, the total of accounts in debit column and credit column are met and tallied.

9.1.2 Some Tips:

Following tips may help to prepare a Trial Balance from a given list of balances:

1. Closing balances of all 'asset accounts', 'revenue expenses accounts', and 'losses accounts' are always debit balances.

2. Closing balances of all 'revenue income accounts' and 'gain accounts' are always credit balances.

3. Accounts of individuals to whom the business owes money have always credit balances and accounts of individual who owe money to the business have debit balances.

4. Loans (taken) account always have credit balance.

5. 'Cash Account' has debit balance.

9.1.3 Mistakes:

If the total of debit and credit column of the trial balance does not agree, it means there are some mistakes in preparing the accounting books. The mistakes, traced, and rectified would tally the Trial Balance.

Mistakes that cannot be detected by Trial Balance are:

* Errors of principle.
* Errors of commission.
* Errors of omission.
* Compensating errors.

After the trial balance is tallied, necessary adjustment entries need be made for closing stocks, prepaid expenses, outstanding expenses, transfer provisions, etc.

**9.2 Profit and Loss Account**:

The preparation of a trial balance only ensures arithmetical accuracy. From the financial accounting system, the user would like to know about the profitability and the operation of the business for a specified period and the position of the business at a given point of time.

A statement which reveals the profitability of operations of a business for the accounting period is called Profit and Loss Account (P & L Account).

###### 9.2.1 Contents of P & L A/c

From all the balances mentioned in the trial balance, those accounts which are for revenue expenditure, revenue losses, revenue income, and revenue gains are taken to P & L Account. This makes it possible to learn whether the business at the end of the accounting period has generated surplus or deficit. All accounts of revenue income and gains are brought on the credit side and all the accounts of revenue expenditure and losses are brought on the debit side of the P & L account. If the total income is more than the total expenditure, the business is said to have generated surplus or profit. But if the total expenditure exceeds the total income during the accounting period, the business is supposed to have made losses. The credit balance signifies profit and on the other hand, debit balance denotes net loss of the business during the accounting period.

**Format of Profit and Loss Account**

Profit and Loss Account of M/s \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

For the Period \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Debit side Credit Side

|  |  |  |  |
| --- | --- | --- | --- |
| **Particulars** | **Amount** | **Particulars** | **Amount** |
| Net profit (balancing figure) |  | Net loss (balancing figure) |  |
| Total |  | Total |  |

9.2.2 Explanation:

1. Particulars: Names of the following accounts are mentioned individually on the debit side of this column:

* All accounts of revenue expenditure
* All accounts of revenue losses

Names of the following accounts are mentioned on the credit side.

* Sales accounts
* Closing stock accounts (if it is adjustment entry)
* Accounts having credit effect of adjustment entries

2. Amount: The respective amount of credit and debit balances of the account that are brought to the P & L Account is mentioned in these columns on debit and credit side against the name of their respective account head.

9.2.3 Notes:

a) It is to be understood that P & L Account contains only ‘Income and Expenditure Accounts’ and not Individual, Personal, or Asset account. The accounts of ‘Income and Expenditure Accounts' get closed when they are brought to P & L Account, while the balance of 'Personal/Individual Accounts' and 'Assets Accounts' get carried forward to the subsequent year.

b) Net Profit and Net Loss: Subsequent to bringing all balances of the accounts to concerned debit and credit side, the total of their balance is made. If the total of credit side is more than the total of debit side then the business is said to have made net profit. The amount by which the total of credit side exceeds the total of debit side of P & L Account is called as 'Net Profit' generated during the accounting period. Likewise, the amount by which the total of debit side exceeds the total of credit side of the P & L Account is called as 'Net Loss' generated by the business during the year. Thus both figures of Net Profit and Net Loss are balancing figures. Adding them up with the total of debit or credit side as the case may be would make the totals of both the sides tally. But when the business generates neither profit nor loss, the total of credit side and the total of debit side of the P & L Account would tally with each other even otherwise. This is a situation where total income is equal to total expenses.

Thus, we can summarize as follows:

(1) Total of Credit Side of P& L A/c > Total of Debit Side of P& L A/c = Profit

(2) Total of Credit Side of P & L A/c < Total of Debit Side of P& L A/c = Loss

(3) Total of Credit Side of P & L A/c = Total of Debit Side of P& L A/c = No profit, No loss

Net profit or net loss is the result of business operations during the accounting period. They are transferred to the balance sheet where the capital account representing the financial involvement of the promoter is increased or decreased appropriately by the figures of net profit or net loss.

**9.3 Balance Sheet:**

# Balance Sheet – Format

Balance Sheet of M/s \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

As on \_\_\_\_\_\_\_\_\_\_\_\_

|  |  |  |  |
| --- | --- | --- | --- |
| **Liabilities** | **Amount** | **Assets** | **Amount** |
| Capital  Reserves and Surpluses  Secured Loans  (Received)  Unsecured Loans & Deposits (received)  Current Liabilities  Provisions  Total | ................  ................  ................  ................  ................ | Fixed Assets  Investments  Loans and Advances (Given)  Current Assets  (1) Stocks  (2) Debtors  (3) Cash  (4) Bank Balance  Accumulated Losses  Total | ................  …………  ................  .. …………  ..............  …………  …………  …………  ………… |

As indicated, the purpose of financial accounting is to ascertain the result of business operation during an accounting year, and to understand the financial position of a business at a particular point of time. Profit and Loss Account serves the former purpose while Balance Sheet serves the latter objective. The accounts pertaining to the groups other than Income & Expenditure, viz. ‘Personal or Individual Account’ and ‘Assets Accounts’ are brought to the balance sheet. Unlike the accounts of the group of ‘Income

and Expenditure Account’ the accounts brought to the balance sheet are not closed. Their closing balances at the time of the balance sheet finalization are carried forward to the subsequent accounting period. They are shown on the balance sheet only to apprise the users about the position of accounts at that time.

The balance sheet provides information on what a business owns and what it owes. Whatever a business owns is termed as ‘Assets’ and whatever it owes is termed as ‘Liabilities’. All liabilities are specified on the left hand side of the balance sheet while assets are shown on the right hand side.

9.3.1 Assets

Assets are classified under the following broad heads:

1. Fixed Assets: Fixed assets are of permanent nature. The total value of fixed assets at the close of the accounting period is shown on the balance sheet.

2. Current Assets: Current assets unlike fixed assets may be converted in the form of 'Cash' or 'Bank balance' short run or at least within an accounting year.

Normally following accounts are termed as 'Current Assets':

a. *Stocks*: Closing stocks of raw material, work in progress, and finished goods.

b. *Debtors*: Individuals who owe to the business (as a result of business transactions) are termed as 'Debtors' or 'Accounts receivables' and are also current assets.

c. *Cash Balance and Bank Balance*: Cash lying with the business, and balance in the bank account of the business are current assets.

3. Investments: The values invested by the business in other ventures are 'Assets' of the business.

4. Loans and Advances (given): Loans or advances made to third parties are Assets of an enterprise. These are not similar to the debtors (Current Assets) as in the case of debtors an individual becomes liable to pay to the business on account of purchase of a product of the business on credit terms.

5. Fictitious Assets: Fictitious assets are not tangible assets but are debit balances of accounts like P & L A/c, Accumulated Losses A/c, Expenses not written off A/c, etc.

# 9.3.2 Liabilities:

On the liabilities side, all 'personal' and 'individual' accounts to whom the business owes are mentioned. Liabilities can be classified in the following broad groups:

1. Capital: Money invested by the promoter is a liability. Business owes that much to the promoter.

2. Reserves and Surplus: Accumulated profit which is not withdrawn and part of profit which is reserved for some specific purpose also belong to the promoters. Business owes that much to the owner. They are, therefore, liabilities.

3. Secured Loans (received): Amount of loans taken by the business is liability for the business. These loans are secured against some assets which are offered to the institution/person who have given loans, as security or collateral.

4. Unsecured Loans and Deposits (received): These loans are also liabilities for the business. However, these loans are not secured.

5. Current liabilities: These are short-term funds taken for financing current assets. Normally, they are credits offered by the suppliers of raw materials and working capital loans given by the banks.

6. Provisions: They are liabilities for which payment provision has been made by the business from the profits, e.g. provision for tax liability.

9.3.3 Note:

The total of 'Liabilities' side and 'Assets' side of the balance sheet must tally. If they don't, there has to be some mistake in preparing Final Accounts, which should be detected and rectified.

**Chapter 11 Costing**

**1. Introduction:**

Initially, cost accounting was being considered to be a technique for `ascertainment of costs' of products/services on the basis of historical data. In course of time, due to more complex and competitive nature of business environment, it was realized that ascertainment of cost was not so important as controlling of the costs as such. Thus, cost accounting started to be considered more as a technique for `Cost Control' rather than a technique of `Cost Ascertainment'. Today, due to technological up gradations and developments in all fields, `cost reduction' is receiving more importance.

Thus, Cost Accounting is concerned with:

* Ascertaining costs
* Controlling costs
* Reducing costs

**2. What is cost?**

The word `cost' is used normally by everyone and has different meanings depending on the context. We are here concerned with its implications to our business and hence, it will be of relevance to us to understand the meaning of the term `cost' in proper perspective.

In general, cost means the amount of expenditure, notional or actual, incurred on or attributable to a thing/product.

It may be noted that there is no such thing as an exact cost or true cost because no figure of cost can be true in all circumstances and for all purposes. Many items of cost of production are handled in optional and objective manner, which may give different costs for the same product or job. The depreciation, notional interest charges, rent, etc., are examples of cost items, which lead to different cost for the same product or service within the accepted principles of costing.

**3. Elements of Cost:**

There are broadly three elements of cost namely Labour Cost, Material Cost and Expenses. A brief off the same is noted below:

1. Material:

The matter or substance from which the product is made is known as material. It may be in a raw or manufactured form. It can be directed as well as indirect.

* Direct Material:

All material which becomes an integral part of the finished product and which can be conveniently assigned to specific physical units is termed as `Direct Material'. The examples are:

* + - All material or components specifically purchased, produced or requisitioned from stores
    - Primary packing materials (e.g. cartons, boxes, etc.)
    - Partly produced or purchased components
* Indirect Material:

All material which is used for purposes ancillary to the production and which cannot conveniently be assigned to specific physical units, is termed as `Indirect Material'. Consumable stores, oil and waste, etc., are a few examples of indirect material.

1. Labour:

For conversion of material into finished goods, human effort is required and such human effort is called `labour'. Again, labour can be Direct or Indirect.

* Direct Labour:

Labour, which takes an active and direct part in the production of a particular commodity/product, is called direct labour. Direct labour costs are, therefore, specifically and conveniently traceable to specific products.

* Indirect Labour:

Labour employed for the purpose of carrying out tasks incidental to goods produced or services provided is called `indirect labour'. It cannot be practically traced to specific units of output. Wages of foremen/supervisors, timekeepers, salaries of salespersons, etc., are some examples of indirect costs.

(c) Expenses:

Expenses may be direct or indirect.

* Direct Expenses:

These are the expenses which can be directly, conveniently and wholly allocated to a specific cost center or unit. (E.g. hiring of some special machinery for a particular contract, commission for a specific product, etc.).

* Indirect Expenses:

These are the expenses which cannot be directly, conveniently and wholly allocated to cost centers or cost units (E.g. rent, electricity, insurance, etc.).

*Elements of cost*

COST

---------------------------------------------------------------------

MATERIAL LABOUR EXPENSES

------------------------- -------------------------- ----------------------------

DIRECT INDIRECT DIRECT INDIRECT DIRECT INDIRECT

**4. Overheads:**

The term `overhead' includes indirect materials, indirect labour and indirect expenses. Thus all indirect costs are overheads. In a manufacturing Organization, these can be broadly divided into three categories:

(a) Factory/Works production overheads, where production is carried out;

(b) Office and administration overheads, where routine as well as policy matters are decided; and

(c) Selling and Distribution overheads, where products are sold and finally dispatched to the customers.

**5. How to calculate total cost?**

Following are the Components of Total Costs:

***Prime Cost****:*

Prime cost consists of cost of direct material, direct labour and direct expenses. It is also known as Basic, First or flat cost.

***Factory Cost****:*

It comprises prime cost and factory or works overheads, which include costs of indirect material, indirect labour and indirect factory expenses. This cost is also known as Works Cost, Production Cost or Manufacturing Cost.

***Office Cost:***

It includes office cost and administration overheads.

Thus, Total Cost has to be arrived at as under:

It comprises cost of production and selling & distribution overheads. It is also termed as Cost of Sales.

Figure given below depicts the relationship between various components of cost:

Relationship between various Components of Cost

DIRECT MATERIAL----------------

+

PRIME COST OR BASIC COST

OR FIRST COST

DIRECT LABOUR-

+

DIRECT EXPENSES ---------------

PRIME COST-------------------------

WORKS COST OR FACTORY COST

+

OR PRODUCTION COST OR

WORKS OVERHEADS-------------

MANUFACTURING COST

PRODUCTION COST--------------

+ TOTAL COST

OR PRODUCTION COST

OFFICE & ADMN------------------.

OVERHEADS

COST OF PRODUCTION---------

+

COST OF SALES OR

SELLING & DISTRIBUTION

TOTAL COST

EXPENSES-----------------------

**Chapter 12 Marketing Management for Small Business**

**1. Introduction:**

New entrepreneurs generally select their projects and set up their units based on the following factors:

1) Success of other entrepreneurs in a particular field of manufacture

2) Some large or medium scale unit indicating its requirements for a particular product and encouraging the entrepreneur to set up an ancillary unit to manufacture that product

3) The entrepreneur noting a shortage of a particular product in the market resulting in high price being paid by consumers for that product or products.

When units have been set up based on any of the above, more often than not they end up with problems.

In the first case, the entrepreneur jumps into a particular field on seeing the success of one or more units since he has money to invest. However, he forgets that there may be many others like him with the same ideas and also with money to invest. As a result too many people enter the same field of manufacture and a situation of over capacity arises. This leads to an undercutting of prices, reduction in margins and eventually evens closing down of several of the units.

In the second case one would feel that since the sales are assured the ancillary MSMEs must do well. In most cases this would be true, but here also there are pitfalls which often bring grief to the ancillary units. For example, if the ancillary unit is supplying its full production to only one customer, viz. the large or medium scale unit, the customer, can often dictate the price. Further if that unit has to reduce production, change its technology or has to close down for any reason, the ancillary unit would be equally affected. The third case may present a very rosy picture in the early stages but the situation can change very quickly. A change in Government's Import Policy or an increase of capacity by a established unit or expansion of a large unit or the restarting of a closed down unit manufacturing that product can make the shortage disappear and can create difficulty for the small units.

The suggested process to follow when setting up a new MSME is to first conduct a market survey to ascertain the true demand and supply position, and also collect information on the other entrepreneurs planning to enter this field (i.e. units in the pipeline). Once it is established that there is a possibility of the unit being able to sustain itself, a pre-production market development programme should be undertaken. This is essential in order to ensure that the unit does not suffer for lack of orders and sales once production has commenced. The role of marketing therefore, commences even before you take a decision to set up a unit for manufacturing a particular product.

**2. Multiple Facets of Marketing**

Generally people confuse marketing with sales. However, sales are only one of the activities of small business marketing. Marketing encompasses the following activities:

1) Research 7) Packaging 13) Credit Control

2) Planning 8) Merchandising

3) Branding 9) Warehousing

4) Pricing 10) After-sales service

5) Distribution 11) Sales promotion

6) Selling 12) Advertising

2.1 Research

This should be a never-ending activity throughout the existence of the MMSME. It starts with a market survey to establish the demand and supply position in order to determine the feasibility of setting up a unit for the manufacture of a particular product. Once the feasibility is established, research is required to identify the customer needs that remain unsatisfied, and to show how the product planned to be manufactured can be modified or designed to meet the unfulfilled needs. In short, one has to see the product as the customer sees it and "customer satisfaction" must be the main criteria for evaluation of all policies and actions.

Even after the unit has gone into production, research must continue on how to improve the product, packaging, distribution, etc., to increase the market.

2.2. Planning

This activity starts at the project stage and is essential throughout the life of the project. At the project stage this would include activities such as planning, market development, decision about packaging, setting up distribution networks, warehousing and short term and long term sales planning. After the unit goes into production it will include sales planning. A sales plan should include a forecast of sales for the future, a plan for territorial coverage, a programme to achieve the forecasted sales and a sale promotion plan, if required.

2.3 Branding

Branding is absolutely essential in consumer products as well as consumer durable and industrial products. This is so because the same product having widely diverse qualities is available from different manufactures $ Besides, it helps the manufacturer, retailer and consumer in the following ways:

1) It enables the consumers in effective and easy identification of the product of a particular manufacturer.

2) The manufacturer benefits from this since the consumer also asks for his specific brand.

3) It enables the manufacturer to have a better control over the sales outlets and price of the product.

4) If the brand is popular it benefits the retailer by attracting consumers to his sales outlet thus helping him in selling other products as well.

When selecting a brand name keep in mind the word RIPPS, where:

R Stands for Remember. The name should be such that it is easy to remember.

I Stands for Image. The name should be such that it creates an image of the product in the consumer's mind.

P Stands for Pronounce. The name should be such that it is easy to pronounce.

P Stands for Protectable. The name should be such that it cannot be easily copied without infringing patents.

S stands for short. The name should be short.

2.4. Pricing

Price is usually associated with

1) Value

2) Status

3) Quality

4) Durability

The point to remember is that a customer is more sensitive to price when the purchase frequency is high or when the quality of competing products is more or less the same. Examples of this are hardware, matches, gums, stationery, chemicals, petroleum products, etc. However, where a customer detects quality variations in brands, the price is immaterial. Examples of these would be razor blades, toilet soaps, cars, machinery etc.

There are five different methods that can be employed in pricing products:

1) In line with similar products already in the market

2) Slightly higher than the price leader in the market

3) Slightly lower than the price leader in the market

4) On a cost plus basis

5) On the basis of profit yield at different sales levels

Attempts at answering these questions will help the entrepreneurs in price fixing.

2.5 Distribution

The objective of a distribution network is to conveniently make available the products to the largest number of customers in required quantities where and when they are needed. This can be achieved through:

1) Agents 5) Manufacturer's own Shops

2) Stockiest 6) Retailers

3) Wholesalers 7) Street Vendors

4) Distributors 8) Mail order Catalogues

The selection of sale outlets will depend on nature of product, number of consumers, and financial resources.

2.6 Selling

A sale can be described as "converting goods into cash". Most people confuse a sale to be booking of an order. However, no sale is complete till the goods have been delivered and their value recovered. This must be kept in mind while assessing the performance of your own sales staff and also while finalizing terms with agents, distributors etc.

The most effective method of selling is personal selling, i.e. through your own-trained staff. This is because no agent, distributor, stockiest or dealer would know your product or its plus points as well as your own sales staff would. However, it is seldom possible for a MMSME unit to resort to personal selling since it cannot afford a sales staff to cover the vast geographical areas of the country. The only exceptions would be if

1) The product is to be sold to a small limited number of customers

2) The demand for the product is so large that sales are restricted to a small area in the vicinity of the manufacturing unit.

Wherever personal selling is resorted to, compensation to salespersons can be in terms of:

1) Salary

2) Salary commission

3) Commission retainer

4) Commission

While commission on sales is one of the biggest motivational factors, other motivational methods are:

1) Merit awards

2) Salesperson’s meetings

3) Contests.

In case of operating through your own sales force the different methods for maintaining effective control are:

1) Sales reports

2) Personal meetings

3) Field visits

4) Fixing of sales quotas

5) Evaluation on basis of compensation earned

6) Territorial development.

However, where selling through outside agencies is involved it is essential that the sales staff of such agencies be given suitable product training and also sufficient sales aids to make them more effective.

To motivate outside agencies the following methods can be employed:

1) Volume discount in addition to normal discounts

2) Contests

1. Dealer Meetings

2.7 Packaging:

The basic reasons for using packaging are:

1) To hold the product

2) To protect the product

3) To attract customers.

Besides keeping the above aims in mind, one must look into the cost of using such packaging when selecting the kind of packaging to be used.

2.8 Merchandising

Merchandising is the art of displaying your products at a point of sale so as to catch the consumers' attention, highlighting the plus points of your product and enticing the consumer into buying the product. This art is mainly applicable in case of consumer goods and consumer durable. Use of display windows, attractive and eye-catching display of products on the shelves and sales counters, hoarding and bill boards outside the sales outlet are some of the methods used in merchandising.

2.9 Warehousing

The normal concept of warehousing is to have a store where goods are kept for safety against theft, weather, rodents and insects etc. While all these reasons for warehousing are certainly applicable, there are other equally important reasons such as:

1) Where the consumers of the goods are located both inside and outside local taxation limits and manufacturer is himself outside local taxation limits, storage of products outside local taxation limits results in money savings.

2) Where high local sales tax is prevalent in one state and the manufacturer is located in another state, warehousing in the state where manufacturer is located and selling interstate, results in saving money.

3) Where transit time is long and consumers are not likely to wait for extended delivery periods, warehousing of goods in proximity of the market will result in increased sales.

4) Where storage cost at location of manufacturer is high and warehousing at lower cost is possible in a place near the consumers, savings in money can be affected.

5) Where excise duties on the product are high and a substantial stock is required to be maintained, operating excise bonded warehouses can result in saving in terms of interest on the duty value for duration of storage.

The above factors and some others, which may affect specific cases, have to be considered when finalizing warehousing arrangements.

After Sales Services

This is a very important activity, which is completely ignored by many entrepreneurs. Most of the new MSMEs are set up by traders who have made money in trading and then decided to enter the manufacturing field. In trading each transaction is an individual deal and once the value of the sales has been recovered the matter is treated as closed. However, a manufacturer cannot afford to take this attitude since he has to manufacture the same product continuously and make repeat sales to the same consumers. Hence any dissatisfaction of the consumer will seriously affect his further sales. Always remember that a dissatisfied consumer can be very adversely vociferous and such reports spread very fast. In case of any complaint by a consumer prompt action in solving the complaint will usually result in the consumer signing praises and forgetting the initial complaint.

2.10 Sales Promotion

This activity is normally resorted to in order to create a temporary spurt in sales. This situation may arise when certain financial commitments make it necessary to raise finances in a short time. The methods usually employed are as follows:

(1) In case where there are more than one products and one of them happens to enjoy a sellers' market, tying up sales of the product in demand with the slow moving items

(2) Offering a special discount for a particular time period

(3) Offering some other manufacturer's fast moving product at a concessional price tied to the purchase of your product

(4) Starting a contest with attractive prizes for the winners and the entry fee being the cash memo, wrappers, etc. of your product

(5) Affixing identification numbers on your products and holding a raffle where lucky numbers are picked and the winning buyer as well as the dealer who sold the winning numbered article are both given attractive prizes.

There can be many more types of promotions depending on the product, the circumstances and the class of consumers that one is aiming to attract. One's own ingenuity must be exercised to determine the best possible promotion.

2.11 Advertising

There is a misguided impression in the minds of most people that advertising is an expensive proposition and can only be done by large units. This impression arises because most people associate advertising with dailies and magazines, radio and television. There are, however, other less expensive avenues as well. The different media are:

(1) Radio

1. Television & Cable TV
2. Hoarding and Neon signs

(4) Bus and Train panels

(5) Bill boards

(6) Cinema slides and shorts film advertisements

(7) Stalls at exhibitions and fairs

(8) Direct mailing of literature

(9) Demonstrations

(10) Free samples for consumers' products

(11) Display of products at public places like bus stand, railway station, and airport.

When the annual sales budget is prepared, a certain provision must be made for this activity and then the available funds must be spent in the most effective manner based on the segment of consumers one wants to send the message to, and the cost of the media used in relation to results expected. Take help of an active and creative advertising agency.

2.12 Credit Policy

Many products can be in `Buyer's market' in the sense that there would be a number of manufacturers/sellers of those products. So, when competition is there, customers demand special services. One of them is credit facility. To buy any product, the person must have purchasing power. The purchasing power may be in the form of cash or loan or credit.

Many a time a customer is not willing to invest in full or in part at the time of purchase. This may be due to lack of funds or unwillingness to take risk with a new product. If an entrepreneur wants to develop his business, he should be able to provide credit facility to his customers. The credit facility builds confidence in a customer for a new product or a new company.

It increases the turnover too. No doubt, no entrepreneur should provide credit facility without planning and understanding. Safety of business must be considered. Many entrepreneurs go on giving credit to develop their business very fast, but many a time they have a rough time recovering the money the customers owe them. Credit facility to a right customer can help both sides the seller as well as the buyer. It is sale of trust along with that at a product. It expands business and market. Credit to a right person, at right time, for a right amount, for a right duration can be fruitful.

An MSME can succeed or fail based on the credit policy it adopts or fails to adopt. Small-scale entrepreneurs are most vulnerable since they have limited finance and the banks quite often are also very conservative when it comes to granting facilities to small units. The more the money is tied up in credit the less the money available for purchase of raw materials and other inputs resulting in reduced turnovers. In short it is better to let go 2% or 2.1/2% margin as cash discount if cash sales are possible in preference to extending credit of 30 days or more.

When it comes to extending credit you place yourself at the mercy of the customer. You may have agreed to 30 days credit and the customer may stretch it out to any period he desires and you would have no recourse except to repeated reminders. Even when dealing with distributors, dealers, stockiest etc. do not extend credit without security. Credit must only be extended after one has had business relations with the party for some length of time and has judged him about his ability, and desire to pay.

As and when credit is extended one must always fix the value limit and time for each debtor. Under no circumstances must the debtor be allowed to stretch the agreed terms. A single relaxation of the credit period will become a permanent feature. Regular reminders seven days before a payment is due and on due date of payment, must form a part of the routine credit policy. Regular statements of accounts must also be mailed at the end of each month to the customer so that he has no opportunity of pleading differences between the final accounts of the manufacturer and his own.

**Summary:**

The suggested process to follow when setting up a MSME is to:

* Conduct market survey
* Collect all available information on market and competition
* Undertake a pre-production market development programme

The role of marketing therefore, commences before you take a decision to set up your unit.

Multiple facets of marketing are:

1. Research 7. Packaging 13. Credit Control

2. Planning 8. Merchandising

3. Branding 9. Warehousing

4. Pricing 10. After sales service

5. Distribution 11. Sales Promotion

6. Selling 12. Advertising

**Tips**

Given below are some tips that can make your marketing profitable:

* Prepare an annual budget, break it down to monthly budget and evaluate the performance against the budget
* Be quality conscious
* Be honest in your dealings with suppliers and customers
* Sell on trust
* Credit to be given should depend on your competitors' policy and your financial budget
* Be careful while giving credit

**Chapter 13 Human Resource Planning**

**1. What is Human resource planning?**

Human resource in its broad sense can be thought of as "the knowledge, skills, abilities and aptitudes of the work-force of an enterprise, as well as of the individuals involved."

Human resource planning is fundamentally concerned with the Human resource demands and sources of Human resource. Human resource planning is very important for any business, small or otherwise. It means a detailed study and analysis of the effective utilization of Human resource.

Earlier, there was a belief and misconception that, where there is plenty of labour available and there is no dearth of trained and skilled labour, no Human resource planning is needed.

But now looking to the changed times and conditions and the present industrial scene, there is a growing realization that there is necessity and urgency of specialized Human resource skills needed for industry. That success or failure of a business firm is largely dependent upon its Human resource (work force) which constitutes one of its most important aspects. Hence, proper attention has to be given to Human resource planning, recruitment, selection and training.

**2. Recruitment:**

Recruitment is concerned with attracting and ensuring a supply of needed personnel and selecting requisite Human resource - the number and quality, as found most appropriate and suitable. You can say that recruitment is the development and maintenance of adequate Human resource.

A study of an Industrial Estate showed that kinship (relatives), friendship, etc. played a significant role in the process of recruitment in a small-scale industry. The entrepreneur generally uses the methods of direct and indirect recruitment. Recommendations of senior employees of similar industries play an important role in recruiting the workforce.

2.1 Sources of Recruitment:

Sources of recruitment and methods commonly in use can be classified in three major groups:

1. Internal

2. External

3. Advertising

The Internal Sources: Of the numerous internal recruitment sources, the most popular in use are:

(i) Employee referrals

(ii) Job posting & bidding

(iii) Temporary workers, and

(iv) Contractors

The External Sources: While considering the sources of external Human resource requirement, it is always advisable to have a systematic and thorough study of the nature of the labour market and find out what types of workforce are available.

External sources for a MMSME can be:

(i) Voluntary applicants

(ii) Labour contractors and casual labour sources

(iii) Employment agencies

(iv) Competitions

(v) Miscellaneous sources like customers and suppliers, etc.

Advertising: Advertising through mass media like newspapers, etc. is another source at Human resource. For a small- scale entrepreneur, though except for one or two higher posts, this is not an affordable source.

2.2 Selection:

Once the entrepreneur or you as a potential entrepreneur have identified the source, attention must be given to the question of selecting the best applicant for the job. As an owner-manager, in the initial stages, you would recruit one or two clerks and typists, a supervisor and eight often skilled or unskilled workers depending upon the requirements of the business.

How do you make the selection for your requirements?

Selection is not an easy process. There is a problem of matching a man to the job. You should select the right man for the right job i.e., an individual who possesses the necessary skill and ability to fill a specific job. Otherwise, a mistake in this may result in low productivity and high labour turnover.

Besides, selection methods should differ as per category of the personnel you intend to select, e.g.

1. Manager

2. Clerk

3. Supervisor

4. Skilled worker

5. Unskilled worker

You should be specific about:

* Skills and expertise you need.
* The kind of experience that will help you.
* Benefits and remuneration you can afford to pay.

2.3 Selection Process:

For this purpose the selection process for a MMSME entrepreneur involves a few fundamentals steps like:

1. Interview

2. Reference checks

3. Preliminary selection by supervisor/foreman

4. Final selection by entrepreneur

5. Placement

Here placement means "the determination of the job to which an accepted candidate is to be assigned and his assignment to the job".

2.4 Induction:

Induction is primarily concerned with the introduction orientation of a new employee into the organization (your unit), his new department and placing him in his new job. In other words helping him to become acquainted with his surrounding by giving him basic information he needs, to settle down in his job.

**3. Training:**

3.1 Importance:

Experts have defined `training' as "the process of aiding employees to gain effectiveness in their present work"; and "the organized procedure by which people acquire knowledge and/or Skills for a definite purpose."

Broadly speaking, training is the act of increasing the knowledge and skills of an employee for doing a specified job.

Training serves to improve employees' skills and knowledge and develops them. It also ensures efficient and economical use of both equipment and material in a factory.

Some of the important outcomes of training in a MMSME are:

* Improved productivity
* Improved performance
* Inducement of self-confidence
* Help in setting up and adaptation to new systems and new equipment as and when required.

You being a small entrepreneur cannot send your workers or other personnel for outside training. So, the training you should provide would be on-the-job training, which is most practical, and most often used training technique in small-scale units. Depending upon the complexity of the job and experience level of the employees, training may before duration of few hours to several months. This type of training can be given by you (owner-manager) if you are a trained person yourself or a senior employee. It should involve three stages:

(i) Job demonstration and explanation of each process.

(ii) Task performance by the trainees by applying what they have learnt in the first stage.

(iii) Work inspection and immediate feedback of the performance.

Training activity is important and is related to job satisfaction, growth of an employee and performance counselling. It is also related to selection of employees. From the point of view of immediate gains to an Organization, in a highly competitive environment with fast changing technology, training of employees plays a crucial role.

The three important elements of training are:

* Training needs identification
* The methodology
* Evaluation of training programmes

Training in order to be effective should be related to the present or the expected future problems of an individual employee or the Organization. It could be a preparation for change in the Organization (including work technology) or for a higher job or responsibility.

3.2 Identification of Training Needs:

Whatever be the objective, before you plan for training, you must identify the needs. This could be done on the basis of:

* Performance appraisal
* Complaints received from customers
* Complaints received from employees
* Discussion with supervisors
* Planning exercise carried out by the Organization.

3.3 Choosing the Training Methodology:

How should the programme be delivered to the participants? For example, should it be through hands-on-training on the machine or through lectures or exercises or any other methods? For small organizations, it would be extremely difficult and expensive to conduct a training programme of its own. Therefore, one should choose a training programme conducted by an external training institution. You should choose a programme depending upon your need.

3.4 Feedback and Evaluation

When an employee returns after attending a training programme, you need to conduct a feedback session in order to examine the benefits the employee has derived from the programmes.

**4. Job Rotation:**

In a small business, it is beneficial that each employee has a thorough understanding of the different functions performed in the unit. In this way, if one of your employees is absent, the machine does not remain idle as other employee can do his job. This objective can be achieved by job rotation. Here, you move employees from job to job for a day or few days depending on the nature of the job.

So, be careful about your recruitment, selection and even training. In today's world of fast changing industrial scenario with extensive competition at home and abroad, your success or rather the very survival, depends on trained, competent workers who in turn, produce quality material resulting in ensured market for your products.

**5.**  **Work Motivation:**

You need to identify the goals and objectives of employees and then design systems so that the objectives of individuals match with those of your Organization.

The following could be listed as the objectives of workers:

- Good wages

- Job security

- Promotion and growth/recognition

- Appreciation of work

- Interesting work or work itself

- Good working conditions/supervision

- Company policy

- Sympathetic understanding of personal problems

- Management loyalty to workers

- Tactful discipline

Money, without doubt, is one of the most important factors that motivate employees. Secondly, money may itself be construed as a reward for good work. However, you must keep in mind that money alone is not going to bring about the desired result. For example, once money is acquired, it no longer acts as a motivator. The other factors (listed above) come into prominence once after the other. Now that you are aware of what motivates the employees, you will be in a position to offer a package that can motivate your employees, keeping, at the same time, the objectives and constraints under which your Organization is functioning.

**6. Tips:**

While planning for Human resource, you may to keep in mind the following:

* Continuous source of labour force must be maintained in order to cope with both planned and unplanned leave of personnel employed. You may find it difficult to get skilled operators at short notice, and this could upset the production and delivery schedule.

* Careful consideration is requiring regarding the number of workers that can be effectively supervised by a supervisor. However, this also depends upon the nature of a job. On the basis o   this, you would be able to make an estimate of the supervisory staff you require for your Organization. You must prepare an Organization chart for the purpose.

* Before finalizing your Human resource plan, try and study the Human resource design in similar Organization.

When your unit becomes operational, the following steps must be taken to ensure availability of Human resource for smooth functioning of your Organization.

* Examine the objectives of your Organization for the next few years. For example, you need to consider what the increase in sale would be during the next few years and also what changes you plan to incorporate in your Organization including the production process. If your sales are going to increase, would it call for additional Human resource, or   would you be able to manage with the existing Human resource? If you need additional hands, at what levels would you need them and when would you need them? Even when you plan to expand to newer geographical areas, you need to do a similar exercise.

* If you plan to introduce sophisticated technology in future, you need to examine whether it is possible to train the existing workers or whether you can consider a reduction in the number of employees etc. On the basis of these factors, you need to forecast future Human resource requirements.
* To help you plan for Human resource, you may make a table showing the existing Human resource in different skills/grades, the estimated skill-wise Human resource with an indication    of when they are required. You also have to ensure that as you change your business processes from time to time, depending upon the market conditions, you need to incorporate this change in the Human resource planning too.

**Chapter 14 Project Implementation**

Setting up a new small-scale venture takes fairly good amount of time. Once you have taken a firm decision to set up your enterprise all your efforts should be directed towards setting it up at the earliest.

**1. Advantages of Early Implementation:**

The advantages of early implementation are many:

a) You can enter into the market early.

b) You can start earning profits well in advance

c) You can reduce your financial burden, since during implementation period you may not have other income

d) All your estimates are more likely to remain valid if the time gap between estimation and implementation is minimum.

A one-day's delay at an early stage may often multiply into days and months later on and might upset your plans. It is not only the loss of times that is a matter of concern, but many troubles that can be caused by it. You will find that all your estimates about costs are upset by price increases and you need more finance to implement the project. Without realizing its implications on profitability, it will be unwise to still proceed. The external factors, for example, which change overnight and cause cost increases are (i) price revision by raw material and/or machinery supplier; (ii) change in government policy, e.g. taxation, import duty, incentives etc.

**2. What Causes Delay in Implementation?**

The possibility of delay could be at any or all the three levels:

1. Decision making level

b) Procurement stage

c) Obtaining necessary permissions/clearances from regulatory institutions

2.1 Decision making Level:

Absence of a proper decision or delay in taking decisions by an entrepreneur is one of the major reasons for delay. The decision may be:

1. To prepare a business plan
2. To compete documentation for financial assistance
3. To decide location
4. To finalize equipment suppliers
5. To finalize partnership or constitution of the firm; or
6. Any other personal reasons.

2.2 Procurement Stage:

Improper estimates and faulty judgment added by certain external, uncontrollable factors deprive entrepreneurs of getting needed resources or facilities as planned. This delay could be in getting:

a) Land

b) Building/shed

c) Loan sanctions or disbursement

d) Cement, steel or other construction materials

e) Power, water connections

f) Machinery & equipment, tools, dies or installation or commissioning of plant

g) Skilled workers

2.3 ‘Compliance’ Level:

Satisfactory compliance with procedural formalities for establishing a new venture is a time consuming and tiring process. Lack of understanding of the need to fulfill these formalities and to comply with them can be a major reason of delay at the entrepreneur's end.

Here are some of the situations contributing to delay:

a) Delay due to non-satisfactory answers to the queries raised by government departments or financial institutions

1. delay in getting ‘No Objection Certificate’ or permissions from relevant regulatory agencies
2. delay in getting approvals, permissions and licenses e.g. approval of building plans, import license, production programme approvals etc

d) Delay in getting disbursement of loan due to non-compliance of legal formalities.

2.4 Errors of judgment:

When an entrepreneur thinks of setting up a venture, rather optimistic assumptions about his own ability and capacity to invest are made. In many cases it has been experienced that the entrepreneur finds it difficult to raise needed funds from the expected sources. Such a situation often leads to delay in implementation.

Sometimes, however, underestimation of funds requirement leads to cash crisis and thereafter delay in implementation. Errors of judgment in estimating costs or funds needed usually involve:

a) Insufficient provision for taxes, transport etc.

b) Absence of provision for contingency

c) Absence of provisions for small tools, dies jigs, fixtures, testing equipment's, etc.

d) Changes in machinery specifications or brands

e) Insufficient provisions for electrification and installation

f) Absence of provisions for preliminary pre-operative expenses.

**3. What should be done to Expedite Project Implementation?**

To ensure speedy implementation the following actions are suggested:

1) List out major requirements and activities for implementation. Group them in terms of priority and specify needed action.

2) Estimate realistically the time required for each activity and problem areas,

3) Forecast effects of delay of one activity or subsequent activities and needed changes for it.

4) Follow-up regularly and closely with financial institutions, your suppliers and all government departments, provide time and resources for these purposes.

5) Make commitments clearly and in written form.

6) Do not be excessively ambitious and hopeful; be practical and realistic too.

7) Tap all your resources and contacts, without waiting for someone to help you.

8) Use information and/or experience of others

9) Anticipate realistically. Try to understand the prevailing practices, rules and regulations and procedures.

10) Make continuous evaluation of your progress and be flexible to change your plans, if need be.

*Summary:*

1. Advantages of early implementation:

* You can enter into the market early
* You can start earning profits well in advance
* You can reduce your financial burden
* All your estimates will remain valid, as the time gap between estimation and implementation is minimum

1. Causes for delay in implementation:

Delay can be at three levels:

* Decision making level
* Procurement stage (land, building, machinery, raw material, etc.)
* Obtaining necessary permission/registrations

1. What should be done to expedite?

* List out major requirements and activities for implementation
* Estimate realistically the time required for each activity and problem areas, especially finance required
* Follow up regularly with financial institutions and other support agencies
* Make commitments clearly
* Be practical and realistic
* Seek and use information
* Tap all resources
* Anticipate hurdles/obstacles realistically.

**Chapter 15 Action Plan for starting an enterprise**

This format helps you in detailing the steps involved in the process. It is necessary a time frame be considered for each action point so that you can keep track of the implementation process. You may use the format below. The blank space against each item is meant to fill in the completion date/week. If you have already taken action with reference to a given item in the format, say so. Further, if a given action point is not relevant to you, ignore the same.

1. Firming up business opportunity that you want to pursue: …………….
2. Conducting market assessment and preparing a report on the same: ………….
3. Preparing Business Plan:…………….
4. Seeking license/permission to set up the business

(trade license for instance): ………..

1. Completing other formalities as per local rules and regulations (add rows if required):

|  |  |  |  |
| --- | --- | --- | --- |
| Sl # | Formality to be completed/permission to be sought | From where? | Schedule for application/sanction |
| 1 |  |  |  |
| 2 |  |  |  |
| 3 |  |  |  |
| 4 |  |  |  |

1. Compiling documents for seeking financial assistance to implement the project (add rows if required):

|  |  |  |  |
| --- | --- | --- | --- |
| Sl # | Document required | From where? (source) | Schedule for collection/compilation |
| 1 |  |  |  |
| 2 |  |  |  |
| 3 |  |  |  |
| 4 |  |  |  |

1. Preparation of Business Plan (add rows if required):

|  |  |  |  |
| --- | --- | --- | --- |
| Sl # | Information required | From where? (source) | Schedule for collection/compilation |
| 1 |  |  |  |
| 2 |  |  |  |
| 3 |  |  |  |
| 4 |  |  |  |

1. Selection and acquisition of business premises:

a) Will you be operating from a rented premise? If so:

i) When will you identify the premises?..............

ii) When will you acquire the same? ……………

1. If you propose to acquire land and construct the premise:

i) When will you identify the land?..............

ii) When will you acquire the same? ……………

1. Preparation of building plans: …….
2. Seeking necessary approvals form regulatory agencies: ………….
3. Commencement of construction: ……….
4. Completion of construction: ……..
5. Filling up application for financial assistance: …………..
6. Submission of loan application: …………….
7. Obtaining loan sanction: …………..(expected date depending on local conditions, size of the loan and the documentation requirement)
8. Human resources:
   1. Identification of required staff/workers: ……..
   2. Recruitment:………
9. Acquisition of fixed asses (other than land/building) (add rows if required)::

|  |  |  |  |
| --- | --- | --- | --- |
| Sl # | Asset to be acquired | From where? | Schedule for acquisition |
| 1 |  |  |  |
| 2 |  |  |  |
| 3 |  |  |  |
| 4 |  |  |  |

1. Acquisition of current assets to commence the business: ………….
2. Any other actions to be taken prior to the comment of the business? (add rows if required):

|  |  |  |
| --- | --- | --- |
| Sl # | Actions to be taken | Schedule |
| 1 |  |  |
| 2 |  |  |
| 3 |  |  |
| 4 |  |  |

1. Arrangements to be made for marketing (identification and selection of distribution chain for instance):

|  |  |  |
| --- | --- | --- |
| Sl # | Arrangements to be made | Schedule |
| 1 |  |  |
| 2 |  |  |
| 3 |  |  |
| 4 |  |  |

1. Commencement of business operations:……..