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Directorate of
Distance Education

P.G. DIPLOMA IN
ENTREPRENEURSHIP

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Paper - 3

Business Opportunity
Identification

MADURAI KAMARAJ UNIVERSITY
MADURAI - 625 021.



ENTREPRENEURSHIP

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P.G. DIPLOMA IN
ENTREPRENEURSHIP

Paper - 3

Business Opportunity
Identification

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Syllabus - Paper 3

BUSINESS OPPORTUNITY IDENTIFICATION

Unit - 1

Introduction : What is Business - dimensions of Economic Activities - Classification of Business.

Unit - 2

Process of Opportunity Identification : Selection of a Small Industry - Feasibility Report - Project Feasibility Analysis - Environment Scanning - SWOT Analysis - Licences - Policies & Regulations - Factory Accommodation - Industrial Estates - Quotas/Tariffs/Excise procedures Machinery - Raw Materials.

Unit - 3

Finance - State Financial Corporation - Commercial Banks - Private, Public small Industries Service Institutes - Capital Budgeting.

Unit - 4

Technological Analysis - Assessing available technology - Evaluating Prospects of Importing Small Industries - NSIC - Subsidies and Tax Holiday.

Unit - 5

Sales & Marketing - Assessing Market Potential for Sales & marketing of Products - Small Industries Service Institutes - NSIC - Subsidies and Tax Holiday.

Books for Reference

1. *Managing Small Scale Enterprises - Vasant Desai - Himalaya Publishing House*
2. *Small Enterprise - Vasis & Vasis - Nialor*

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UNIT - 1

NATURE AND SCOPE OF BUSINESS

Business includes various activities and all the activities that are carried on by and for people are underlined in the definitions quoted below.

Business represents the "organised efforts of enterprises to supply consumers with goods and services."

Business "is a system created to satisfy society's needs and desires."

A business "is nothing more than a person or group of persons properly organised to produce or distribute goods or services. The study of business is the study of the activities involved in the production or distribution of goods and services - buying, selling, financing, personnel and the like. In a theoretical sense, this definition of business is incorrect. Before an activity can be considered a business, there must exist both the goal of profit and the risk of loss.

Business is that "complex field of commerce and industry in which goods and services are created and distributed - in the hope of profit within a frame work of laws and regulations.

Business "comprises all profit-seeking activities and enterprises that provide goods and services necessary to an economics system. It is the economic pulse of a nation, striving to increase society's standard of living. Profits are a primary mechanism for motivating these activities.

The last three definitions introduce one more element, viz., profit. A business must make profit to succeed. Profit is income minus outgo. It is the main incentive for starting a business. Business people weight each of their decisions and actions in terms of making profit and avoiding loss.

The sum up, business may be understood as the organised efforts of enterprises to supply consumers with goods and services and to make profit in the process.

Scope of Business

Business is a vast and fascinating subject. The more one reads about business, the deeper it goes and more absorbing does it become. The subject encompasses the use of latest scientific know-how and technical do-how, challenges and difficulties encountered in converting raw materials into saleable products, problems confronted in raising and spending money for the good of business, the uphill task of bringing employees together and motivating them to achieve higher productivity, sleepless nights spent for better marketing of the products, the stupendous task of complying with legal restrictions and government requirements and discharging obligations to consumers, employees, owners and to other interest groups which have stakes in business directly or indirectly.

CHARACTERISTICS OF TODAY'S BUSINESS

Today's business has the following characteristics (see Fig 1.1)

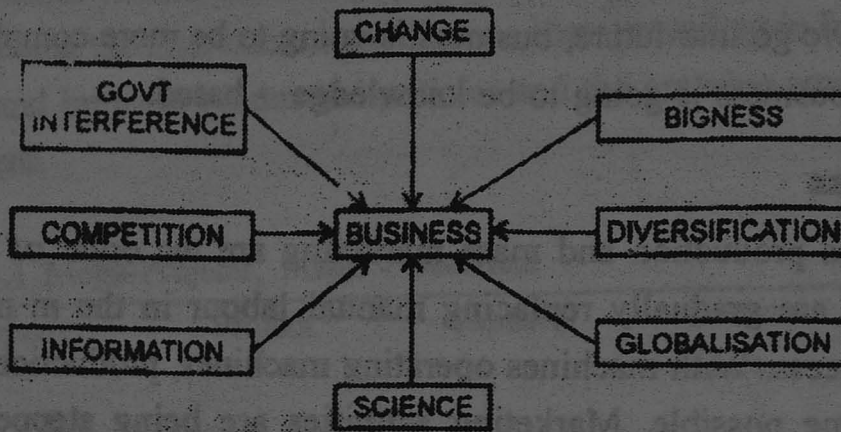


Fig 1.1. Characteristics of Business

1. Change

If there is any single word that can best describe today's business, it is change. Modern business is dynamic. New technologies herald the arrival of new products leaving behind the old ones. "Today's growth product", aptly remarked Theodore Levitt, "may be tomorrow's earthen pot." Incandescent lamps put off kerosene lamps. Man-made fibers have almost outdated cotton fabrics. Luna, TVS XL 50, Hero Honda and other mopeds have made Vicky, Dart and Mayuram, one time popular two wheelers, disappear from the market. Bajaj bid a good-bye to Garnar and Lambretta. Dot pens have allowed ink pens to dry up. TVs have compelled radio to rust and cassettes have retired disc-type music. Job typing is on the wane thanks to xeroxing. Handwinding time-pieces are pushed aside by quartz watches. This type of change makes the business people spend vast sums on R and D and be ever vigilant in adopting new technologies.

As we go into future, business is going to be more complex. Specifically, business is going to be knowledge - based.

2. Bigness

Mass production and mass marketing are the order of the day. Machines are gradually replacing manual labour in the manufacturing process. With machines operating machines, production in bulk has become possible. Marketing activities are being stepped up to match massive production. New channels of distribution, super-bazaars, discount houses, and trade fairs have sprung up to meet the challenges of mass production. Turnover in hundred of crores is the order of the day and sales below Rs. 100 crore are laughed off these days.

Mass production and mass marketing fetch economies of scale to the manufacturers and the benefits will be passed on to the final buyers.

The trend towards growing big is evidenced by the increasing presence of our companies in the Fortune 500 internationals.

Big is not always bountiful. It can even be trouble as some of our industrialists have realised. Projects are faltering or have faltered, cost and time overruns are becoming more of a rule than the exception (see Table 1.1) and some ventures are almost shelved.

The most obvious reason for this phenomenon is Indian industries are inexperienced in implementing mega projects (operating in protected markets did not call for huge capacities). But there are

various other factors that companies have to reckon with, the most important being the high interest and finance costs prevailing in India, inconsistent and immature industrial policies and the growing environmental movement.

Table 1.1 Mega-Projects, Mega - overruns

Company	Project	Capacity	Overrun	
			Time	Cost (Rs. Crore)
Reliance	PTA	3,50,000 Pta	11 months	*
	Crackes	6,00,000 Pts	3 years	400
Essar Steel	HR Colls	2 million Pta	3 years	*
Jindal Tractabel	Power	240 mw	*	200
SVC Superchem	PTA	1,20,000 tps	8 months	100
Sterlite	Copper ametter	1,00,000 tps	11 months	*
BSES	Power	500 mw	6 months	*
Lan Eseda	Sponge iron	1,50,000 Pts	27 months	*
Bindal Agro	Urea/Ammonia	3,650 Pta	4 years	660

3. Diversification

Today's business is characterised by diversification. The product portfolio of any medium or large business house reads like who is who. The Tata group, a premier business house, has already iron and steel, fertilisers, light commercial vehicles, power, chemicals, tea, textiles, shipping, hotel services, electronics, marine products, printing, oil and consultancy under its belt. It has now plans to foray

into such areas as passenger cars, computers, biotechnology, housing development and leasing activities. More versatile is the product portfolio of J.K. group of companies. The group has developed into a veritable industrial empire with interests in textiles, metals and engineering, computers, paper and boards, plastics, chemicals, tires and tubes, cosmetics, dry cells, agricultural machines, paints, cement, sugar, shipping, commerce, finance and exports and imports.

Aditya Birla of the Birla group has summed up the prevailing trend in our industries. "Our basic policy is" told he, "not to depend on any one sector for growth or profits. Most industries go through cyclical phases. Our investment pattern has been geared to ensure that even if there is a down turn in one, the others will continue to generate profits".

Product proliferation is another characteristic of many a business. Product proliferation represents introducing different brands in the same product line. Hindustan Lever, for example, has Liril, Pears, Rexona, Lux and Lifebuoy in one line.

Diversification, on the other hand, implies introducing different lines of products, mostly unrelated to each other. Diversification and product proliferation are used as measures to face severe competitions so characteristic of modern business.

The diversification characteristic, common to our business houses, contrasts with what most excellent companies in America do. One of the attributes of the excellent companies in America, point out Thomas J. Peters and Robert H. Waterman, in their book *In Search*

of Excellence, is that the companies 'stick to the knitting.' IBM, for instance, has been concentrating on business machines, Caterpillar on tractors and Ford on automobiles.

Thanks to liberalisation policy of the government, many companies in our country stretched too far-all in the name of diversification. The result has been disastrous. Several bigwigs burnt their fingers. DCM, Brooke Bond, ITC, Larsen and Toubro, Indian Organic Chemicals, Nelco, Eskeyef, Rambaxy Laboratories and Britannia are examples of companies that courted failure by diversification.

How to avoid failures ? The following 10 commandments are highly useful.

- i) If you are not big enough, don't try diversification
- ii) If you lack staying power, stay clear of grandiose of diversification
- iii) Look before you leap.
- iv) If possible be the first in the race.
- v) Where feasible, float a new company
- vi) Check whether you have the marketing skills necessary in the new business.
- vii) Be ready to accept your limitations and compromises.
- viii) If you are a small player, it is better to have a small ego.
- ix) Tax saving alone is not good enough to foray into new areas.
- x) It is no crime to remain undiversified.

Closely related to diversification is the merger and acquisition

wave sweeping across the country. With the revision of the provisions relating to regulation of monopolies in the MRTP Act, 1969, many companies went acquiring or merging with others in a big way. Table 1.2 shows the number of take overs over a period of seven years.

Table 1.2 Number of takeovers by year.

Year	Number of take overs
1988	15
1989	18
1990	25
1991	33
1992	30
1993	114
1994	150 (Provisional)

(Source: IIM-C, Database on M & A as reported in Business Today, March 22-April 6, 1994, p. 69).

Table 1.3 reveals names of some recent takeovers in the country.

Table 1.3 Recent takeovers

By	Of
Hindustan Lever	TOMCO
General Electric	Godrej Refrigerators
Proctor & Gamble	Godrej Soaps
Coca-Cola	Parle Soft Drinks
Pepsi Co.	Duke Soft Drinks
Brooke Bond	Kissan (Food Products)
Heinz Glaxo	Food Products

By	Of
Whirlpool	Kelvinator Refrigerators
Honda	Kinetic Honda
Godrej	Good Night (Domestic Pest Control Products)
Essar Shipping	South India Shipping
Macneill Magor	Eveready Batteries

4. Globalisation International is yet another quality of modern business. Political boundaries are no barriers to business. Production facilities are being set-up in different countries and products are being sold world wide. Gradually, business houses are exposed to global competition which augurs well for consumers.

In fact internalisation or globalisation is fast becoming imperative for modern business due to technological innovations, crumbling trade barriers, global flow of capital and technology, information explosion, intensity of market competition, changing life style and the demand for new products. The success achieved by Japan and other Asian countries has demonstrated that imaginative and supportive economic and trade policies domestic and external, accent on technological innovation, product design, quality, price, marketing strategy and infrastructure backup play a vital role in carving a niche in the international business arena. Internationalization of business is a means of sustaining a strong domestic base in terms of technology, product, market and capital over a longer period.

5. Science

Also occupying a major role is science. The development of atomic power, advances in metallurgy and allied fields, accomplishments relating to the space-age programmes, application of mathematics in managerial decision - making, and progress in miniaturisation are illustrations from the myriad of contributions being made to business by science. And many more are to come. Future scientific breakthroughs will offer attractive opportunities to alert businessmen. Current means of manufacturing and selling will be scrapped in order to remain competitive, and new means of financing these tremendous changes will be developed.

6. Information

Another characteristic of contemporary business is the recognition of and need for information. The whole area of information getting and giving, including data processing, information systems analysis, and preparation of effective records and reports, has achieved a major status. The complexities of modern business and government requirements have spear-headed this growth. But the vital reason for progress in this area is the availability of the computer and electronic devices that have made feasible the quick and accurate gathering, processing, and distributing information. Man is now free with the druggery of much detailed paper work. He can further enhance progress by feeding proper information to proper people.

Mean while, information technology (IT) itself is subject to revolutionary changes. From a hand written sheet of paper to typing to stencil cutting to photocopying to floppies to cyberspace the advancement in information

industry is breath taking. As business gets globalised, online communication across the world would be highly useful.

7. Government Interference

Interference of government in business is common in every country. In the name of self-reliance and protecting domestic industry, restrictions are placed on the import of foreign goods. In order to reduce inequalities of income, to prevent concentration of economic power and to realise other socio-economic objectives, governments impose restrictions and levy taxes on domestic industries. Today, there is no government in the world which does not interfere in business activities in some respect or other.

Interference of government in business was on the ascendancy upon 1980's. During 1950's, 1960's and 1970's there was a broad consensus that governments must intervene directly and play active role in economic development. Faith in the government was so much that the World bank, a capitalist institution, was reluctant to lend to countries that did not have a government sponsored development plan.

With all this, no economy is totally free from government role. What has happened in the recent past is that the degree of government's interference has come down but the involvement is there nevertheless.

8. Competition

Competition is another feature of modern business. Gone are the days of sheltered markets, subsidies, licences, quotas and restrictions. Businessmen are asked to stand on their feet, to eliminate inefficiencies,

cut down costs and improve productivity. Fit test will survive. Inefficient and marginal firms will be forced to wind up.

Competition is beneficial to the competing firms besides benefiting the consumers. How competition benefits consumers is obvious. To substantiate how competition benefits rival firms we quote Michael Porter. "Companies benefit from having strong domestic rivals", says Porter, "aggressive home based suppliers and demanding local suppliers competing domestic rivals will keep each other honest in obtaining government support. Companies are less likely to get hooked on the narcotic of government contracts or creeping industry protection."

BUSINESS GOALS

Before we discuss business objective, it is essential to be clear about the meaning and scope of three concepts, viz. missions, goals, and targets.

Mission

Mission is a statement which defines the role that an organization plays in a society. It answers three fundamental questions which peter F Drucker has raised. They are: What is our business ? What will it be ? What should it be ? Mission statement also defines an organisation's direction and provides for its continuity and growth.

A few example of mission statements are:

- i) "Building Trust World-wide" Maruti
- ii) "Infrastructuring India" Vizag Steel

- iii) "Where Growth is a Way of Life" Reliance
- iv) "Miles and Smiles" Modi-Luft
- v) "Success in Different Moulds" ISPAT
- vi) "Serving Society Through Industry" Nagarjuna Group.
- vii) "Making Quality a Way of Life-Worldwide" IFB
- viii) "Integrated Technology Group" Daimler Benz
- ix) "Serving to Grow, Growing to Serve" Canara Bank
- x) "The common Man in Sharper Focus, to Encourage. Saving and Investment Habits Among Them" UTI
- xi) "A World- Class Competitor" HCL

The 1990's have forced companies in our country to redefine perspectives, and reorient activities. It has required extensive self-examination to evolve a totally different focus, values and perceptions to survive.

But change in the fundamental assumptions of a corporation, is not easy to make, or to communicate. An entirely different attitude and value system needs to be embedded in the minds of people who work in the organisation. The new value systems need to be conceptualised, verbalised and then internalised.

Once mission statement is formulated, efforts must be made to realise it. Based on customer feedback, HCL for example, was able to convince its Japanese partner NOKIA to redesign its pager, incorporating more features like higher memory storage. Eicher takes up assignments only if the jobs can stand upto the litmus test enshrined in its statement, even if it means refusing business. A request from a north African company was turned down because the assignment did not fit in with the mission statement.

Mission statement, though a guide map to success, is not a magic formula for profitability, nor is it the only contributor to better performance. Often, the mission statement may land a corporation into serious trouble as has happened to Daimler Benz. Transforming it self from a mere car maker into an "integrated technology group", Benz involved itself in aerospace, micro-electronics and many kinds of transport. There were reckless acquisitions (since 1985) which were mostly unprofitable.

Objective

Where mission indicate the overall philosophy for which the company stands, objective or goal refers to the operational side of the business. The mission statement, when translated into figures indicating yearly budget, we have the company's goals. A series of such yearly goals, when achieved, give the statement its relevance.

Targets

Targets will have much shorter time span. They may be set for one week, one month, three months or even for one year.

Reaching targets will enable a company realise its goals. Goal realisation continuously will lead to mission-fulfillment.

Having understood the nature of mission, goal and target, we propose to elaborate on the different organisational goals.

It may be stated that a typical business establishment seeks to achieve more than one goal and there are always restraints to the attainment of some goals. Objectives vary with the passage of time. Goals common to most contemporary business establishments are

explained below. (also see Fig 1.2)

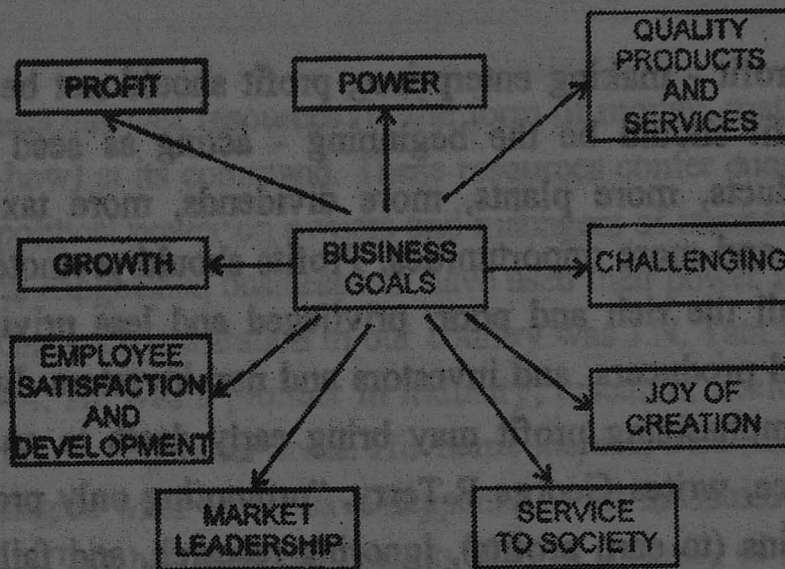


Fig 1.2 Business Goals

1. Profit

Making profit is the primary goal of any business enterprise. Profit, as was mentioned earlier, is the excess of income over expense. Profit is the main incentive, motivator, strong sustainer, judicious allocator of resources, objective indicator of productivity, and a solid basis for growth, expansion and survival. Profit enables a businessman to realise his other objectives too.

Not all enterprises are interested in making profits. For example, hospitals, schools, charitable institutions and government agencies are not basically concerned with the acquisition of profits. The non-profit enterprise customarily rely on gifts, endowments, receipts from money raising projects, subsidies, or taxes for sustenance. The basic objective of these

establishments is the provision of a service which is socially desirable and useful.

In profit - making enterprises, profit should not be the end in itself. Profit should be the beginning - acting as seed money for more products, more plants, more dividends, more tax payments, more jobs and more opportunities. Profits should promote the well - being of all the rich and poor, privileged and less privileged, consumers and producers, and investors and non-investors. Ignoring this and overemphasizing profit may bring early death to an enterprise. For instance, writes George R. Terry, "promoting only products with high margins (to earn profits), ignoring research, and failing to provide working conditions satisfactory to employees, may in the ultimate, bring about the demise of an enterprise."

2. Growth

Growth is another primary objective of business. Business should grow in all directions over a period of time. An enterprise which remains stagnant for long is presumed to suffer from an organic defect.

The strategies adopted to achieve growth are,

- a) add more product/markets.
- b) diversify into a new areas
- c) integration - forward or backward
- d) increase market share
- e) expand markets or

- f) cut down costs and increase productivity.

3. Power

Business has vast resources (in the form of money, materials, men and known-how) at its command. These resources confer enormous economic and political power on owners and managers of business ventures.

Several enlightened businessmen have used their power for the good of society. One such illustration in our country was J.N. Tata who passed away in 1904. He was a pioneer in industry, research, health care, art, literature and in many other areas. His name inspires awe and respect. It is hard to imagine what would have happened to the industrial map of our country if J.N. Tata had not been born in 1839 in a family of parsi priests in Gujarat. "He was above all a patriot", wrote The Times of India (April 13, 1912) "who made no public speeches. To his mind wealth and the industry which led to wealth, were not ends in themselves, but means to an end, the stimulation of the latent resources of the country and its elevation in the scale of nations.

4. Employee Satisfaction and Development

"If you want to plan for a year, plant corn. If you want to plan for 30 years, plant a tree. But if you want to plan for 100 years, plant men" so goes a Chinese proverb. Caring for employee satisfaction and providing for their development has been one of the objectives of enlightened business enterprises.

Concern for employees continues to be an important aspect of management, contrary to an expectation that human element will lose

its significance thanks to automation. In fact, quality of personnel is considered to be one of the hallmarks of best managed and highly respected companies. In the two studies conducted by the Business World, viz., India's Most Respected Companies (1991) and India's Best Chief Executives (1993), personnel factor was one of the criteria used.

Tatas are a legend in pursuing this objective. Either in implementing labour welfare measures, constituting safety and security measures, or in providing training and development facilities, the name of Tatas should be mentioned first.

5. Quality Products and Services

Providing quality products and services is yet another objective of business. Those who insisted on and persisted in quality survived competition and stayed ahead of others on the market. Persistent quality earns brand loyalty, a vital ingredient of success. Hindustan Lever is flourishing mainly because of the quality of its products. Some of its products like Liril, Vim, Lifeboy, Surf, Rin, Sunlight, Signal, Close-up, Lux, Rexona, Pears and others have become household names throughout the country. These products are accepted by buyers as safe, of high quality and reasonably priced. Behind its quality products, Hindustan Lever has an excellent R and D set-up and a high degree of professional management. The company is sitting pretty and is almost invincible.

There are other business people who believe in quick money. Quick money comes through short-cuts. These are the people who give us razor blades which fail to give us one smooth and neat shave, bulbs that do not

give at least 100 light hours of service, leaky taps and adulterated goods. Such enterprises will not survive for long.

6. Market Leadership

To earn market leadership is yet another objective of business. To earn a niche for oneself in the market, innovation is the key factor. Innovation may be in product, advertising, distribution, finance or in any other field. Blow Plast retains its market leadership by introducing soft luggage bags and totes. Hindustan Lever earned leadership in tooth paste by introducing mouth wash in its 'Close-up'. Asian Paints adopted unconventional channels for the sale of its paints, which has pushed them ahead of their competitors. Ambani of Reliance Textiles introduced convertible debentures which have become attractive. This and other financial wizards enabled Reliance to receive unprecedented response from investing public to any of its issues of securities.

7. Challenging

Business offers vast scope and poses formidable challenges. Success in a business venture smacks of the abilities of individuals who own and failure betrays their inability and incompetence. The worth of an individual is tested more in business than in any other profession.

8. Joy of Creation

It is the business through which new ideas and innovations are given a shape and are converted into useful products and services. (See box)

Box

Story of Xerox

The story of Xerox has an old-fashioned, even a 19th century, ring-the lonely inventor in his crude laboratory, the small, family-oriented company, the initial setbacks, the eventual triumph, gloriously vindicating the free-enterprise system.

The story flashes back to 1938 and a second-floor kitchen above in a bar in Astoria, Queens, which was being used as a makeshift laboratory by an obscure 32 year old inventor, named Chester F. Carlson. The son of a barber of a barber of Swedish extraction, and a graduate in physics of the California Institute of Technology, Carlson was employed in New York in the patent department of P.R. Mallory and Co. In quest of fame, fortune, and independence, Carlson was devoting his spare time to trying to invent an office copying machine, and to help him in this endeavour he had hired Otto Kornei, a German refugee physicist. The fruit of the two men's experiments was a process by which, on October 22, 1938, after using a good deal of clumsy equipment and producing considerable smoke and starch, they were able to transfer from one piece of paper to another the unheroic message "10-22-38 Astoria." Thus photocopying was born.

The idea of photocopying was then taken over by one Mr. Joseph C. Wilson of the Haloid Company which was manufacturing photographic papers. Overshadowed by the giant in the field, namely, Eastman Kodak, and dispirited by the Great Depression, haloid Com-

pany was desperately looking for a new product which would bail the firm out of trouble. The idea of photocopying inherited by Carlson was a godsent opportunity to Haloid Company. Not that the company could reap fortunes out of the idea immediately. For several years sleepless nights were spent and millions of dollars were poured into further improve the idea of Carlson. Only in 1950's the real break through was achieved and from then onwards it was smiles all the way to the bank for everyone associated with the Haloid Company, which was subsequently named as Xerox Corporation. It was indeed joy of creation for both carlson, the inventor as well as for Joseph Wilson, the developer. (See Business Adventures by John Brooks).

Although it may be too difficult to list all the products and services that the business had provided us till now, it is interesting to mention that in the coming two or three decades the following will receive considerable attention from researchers and business people.

- * Readily available artificial human organs, except the brain.
- * A means of transportation without an automobile, perhaps an individual flying machine.
- * Drugs to cure or prevent cancer and the common cold.
- * A personal telephone, no larger than a cigarette pack, the can be used from any location.
- * Clothing that can be cleaned by placing it in a 'cleaning chamber for one minute.
- * A synthetic material to replace wood.
- * A simple injection to determine the sex of an unborn child.

Will there be a greater joy to a businessman than coming out with, say drug which can cure cancer ? Let us wait and see who that great saver would be.

9. Service to Society.

Business is a part of society and has several obligations to wards it. Some of them are.

- i) Providing safe and quality goods at reasonable prices.
- ii) Providing employment
- iii) Patronising cultural and religious activities,
- iv) maintaining and protecting ecology, and
- v) supporting less privileged sections of people in society like Scheduled Castes and Scheduled Tribes, physically handicapped, women and children.

Services of society is the main objective of a non-profit-making enterprise. Profit - making enterprise cannot afford to have service as the primary objective. It will be a secondary objective.

10. Good Corporate Citizenship

Good corporate citizenship implies that the business unit complies with the rules of the land, pays taxes to the government regularly, discharges its obligations to society and cares for its employees and customers.

Bending rules of the land, evading tax payments by under invoicing exports and dubious tax-planning, cornering licenses at the

cost of others, adulterating quality of products, and indulging in other unethical practices may earn money. But such practices hardly speak highly of corporate citizenship. The tatas are a contrast to the general trend. Unethical practices are anathema to the Tatas. The best way to substantiate this claim is to quote J.R.D.Tata. "This factor has also worked against our growth. What would have happened if our philosophy was like that of some other companies which do not stop at any means to attain their ends. I have often thought of that and I have come to the conclusion that if we were like these other groups, we would be twice as big as we are today. What we have sacrificed is a 100 percent growth.

WHAT IS ENVIRONMENT ?

Environment refers to all external forces which have a bearing on the functioning of business. "Environment factors or constraints", wrote Barry M.Richman and Melvyn Copen, "are largely if not totally, external and beyond the control of individual industrial enterprises and their managements. These are essentially the 'givers' within which firms and their managements must operate in a specific country and they vary, often greatly, from country to country.

The environment poses threats to a firm or offers immense opportunities for exploitation. Stressing this aspect, William F.Glueck and Lawrence R.Jauch wrote thus. "The environment includes factors outside the firm which can lead to opportunities for or threats to the firm. Although there are many factors, the most important of the

sectors are socio-economic, technological supplier, competitors and government.

As per the second definition, environment includes such factors as socio-economic, technological, supplier, competitor and government. While all these are highly relevant, there are two more factors which are not included in the definition, and which exercise considerable influence on business. They are physical or natural environment and global environment. Including these two the total environment of business, for our purposes, will include six factors, viz., political-legal, economic, social-culture, technological global and natural. As can be seen in the subsequent chapters, all these factors are explained in great detail. A brief description of each, however, follows in the following paragraphs.

Technological environment exercises considerable influence on business. Technology is understood as the systematic application of scientific or other organised knowledge to practical tasks. It is through business that technology reaches people. Technology changes fast and to keep pace with it, businessmen should be ever alert to adopt changed technology to their businesses.

Economic environment refers to all forces which have an economic impact on business. Industrial production, agriculture, planning, basic economic philosophy, infrastructure, national income, per capita income, money supply, price level, population, savings, stages in the economic development and trade cycles are major factors which make up the total economic environment. There is close rela-

tionship between business and its economic environment. Business obtains all its needed inputs from economic environment and it absorbs the output of business units.

Political environment refers to the influence exerted by the three political institutions, viz., legislature, executive and judiciary in shaping, directing, developing and controlling business activities. The legislature decides on a particular course of action of the executive, also called government, implements whatever was decided by parliament and the judiciary plays the watchdog role in order to ensure that both the legislature and the executive function in public interest and within the boundaries of the Constitution. A stable and dynamic political environment is indispensable for business growth.

Yet another environmental factor which is fast emerging as the force to reckon with is the global or international environment. Thanks to liberalisation Indian companies are forced to view business issues from global perspective. Business responses and managerial practices must be finetuned to the global environment. Manager must understand that safe and protected markets are no more there, that world is becoming small in size thanks to advanced means of transport and communication facilities, that learning of foreign languages is a necessity that acquiring familiarity with strange and changing currencies is a must, that facing political and legal uncertainties is inevitable, and that adapting their products to different customer needs and tastes would only help them survive amidst intense competition. Implications of global environment are elaborated in one of the subse-

quent sections.

Thus, business is the product of the technological political legal, economic, social-cultural, global and natural factors amidst which it functions. Three features are common to this web of relationship between business and its environment. First, there is symbiotic relationship (see fig. 1.3) between business and its environment and among the environmental factors. In other words, business is influenced by its environment and in turn, to a certain degree, it will influence the external forces. Similarly, political-legal environment influences economic environment and vice versa. The same is the relationship between other environment factors too.

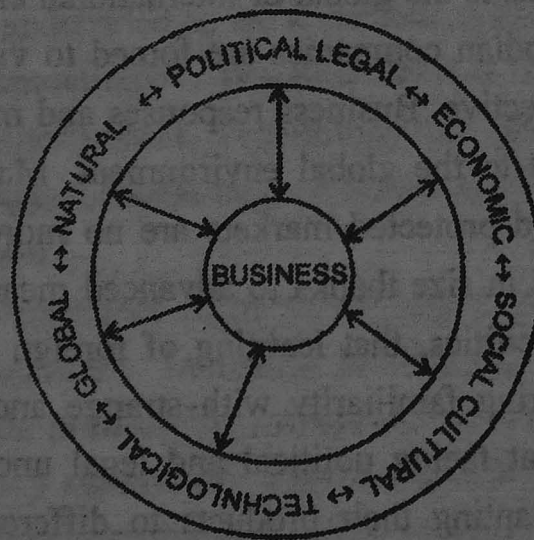


Fig 1.3 Symbiotic Relationship between Business and its environment

The second feature is that these environmental factors are dynamic. They keep on changing as years roll by, so does business.

The unique feature is that a particular business firm, by itself, may not be in a position to change its environment. But along with other firms, business will be in a position to mould the environment in its favour, to a large extent.

OBJECTIVES AND USES OF STUDY

Environmental analysis has three basic goals. First, the analysis should provide an understanding of current and potential changes taking place in the environment. It is important that one must be aware of the existing environment. At the same time one must have a long term perspective too.

Second, environmental analysis should provide inputs for strategic decision making. (see Fig.1.4). Mere collection of data is not enough. The information collected must be used in strategic decision making.

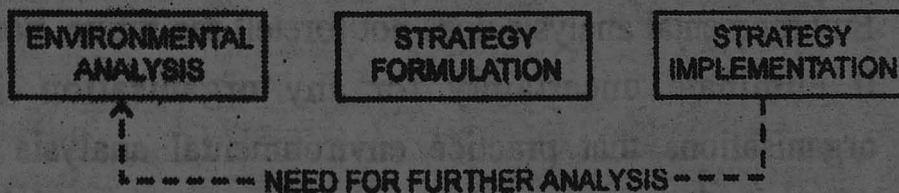


Fig. 1.4

Third, environment analysis should facilitate and foster strategic thinking in organizations - typically a rich source of ideas and understanding of the context within which a firm operates. It should challenge the current wisdom by bringing fresh viewpoints into the

organisations.

To be specific, the benefits of environmental study are as follows:

1. Development of broad strategies and long-term policies of the firm.
2. Development of action plans to deal with technological advancements.
3. To foresee the impact of socio-economic changes at the national and international levels on the firm's stability.
4. Analysis of competitions strategies and formulation of effective counter - measures.
5. To keep oneself dynamic.

Limitations of Environmental Analysis

Environmental analysis, as with any other analysis has certain limitations. These limitations are.

1. Environmental analysis does not foretell the future, nor does it eliminate uncertainty for any organisation. Thus, organisations that practice environmental analysis some times confront unexpected event - events not anticipated. during environmental analysis. Environmental analysis, however, should reduce the frequency and extent of surprises that may confront a company.
2. Environmental analysis in and of itself is not a sufficient guarantor of organisational effectiveness. It is only one of

the inputs in strategy development and testing.

3. The potential of environmental analysis is often not realised because of how it is practised. It is sometimes used as a crutch for post hoc reflections. At times managers place uncritical faith in the data without thinking about the data's verifiability or accuracy.
4. Too much reliance is often placed on the information collected through environmental scanning. When there is overloading of information, one is likely to get lost and become inactive typical of 'paralysis through analysis syndrome'.

Take the case of Norton Company, an industrial abrasives manufacturer and a competitor of 3M in the U.S. Norton faithfully studied environment and followed all management models, systems and procedures. In spite of all Norton's state-of-the-art management systems, its performance remained disappointing. Persistently poor results left the company vulnerable and, in 1990, it was absorbed into the French giant, Compagnie de Sanit-Gobain.

Mean while, 3M achieved success but following a different path. The company did not get caught by the paralysis syndrome. Leaders here placed little emphasis on top-down planning and control. Instead, they nurtured the innovative ideas of sales engineers and sales representatives, thereby building an entrepreneurial engine that generated a stream of profitable new products and promising new technologies. Going into post-war boom, 3M and Norton were roughly the same size. By the mid-1980s 3M was reporting sales

eight times those of its old competitor. Ironically, Just as Norton was swallowed up by Saint Gobain, 3M was named for the fifth time in six years to Fortune's list of the Ten most Admired Corporations.

Success lies in adventure. It eludes those who hesitate to step forward. Environmental analysis often makes an individual too cautious in his approach and he is likely to be overtaken by events.

PREPARATION OF THE PROJECT REPORT

The project report being compiled by the entrepreneur should accomplish the vital task of providing a 'bird's eye-view' of the entire spectrum of activity.

(i) Technical feasibility

This would encompass factors such as the description of the product specifications to be adopted, raw material availability as per requirements, outline of manufacturing process inclusive of a flow-processes chart, quality control measures, power supply, availability of water, transport facilities and communication network.

(ii) Economic viability

This essentially involves the compilation of demand for domestic and export markets, most appropriately installed capacity requirements in regard to capital assets, evaluation of the production cost, capturing a substantial share of market sales, revenue expected, suitable price structure, and so on.

(iii) Financial implications

Project cost covering non-recurring expenses such as land and building, plant and machinery, pre-operative expenses and so on and recurring expenses such as work capital needs, raw material needs, wages for personnel, etc. will have to be worked out in detail. The probable cost of production over a period of five year is to be assessed and expenses such as fixed and variable expenses, and 'break-even' analysis should be presented. Besides, profit per month, percentage of profit on total investment and percent age of profit on the expected sales should also be computed and furnished.

(iv) Managerial competence

The new entrepreneur manager entering the small-scale sector should devote his full attention to the new venture and should consider the product line chosen as a 'major economic activity'. He should develop a keen desire to adopt modern management practices for ensuring its successful growth. He should endeavour to put on the market a product in his own style in an innovative spirit without blindly imitating other brands.

He should maintain up-to-date records pertaining to actual production, sales effected every month, in addition to gathering useful data on potential customers, new market segments, changes in fashion, usage, design, style, etc. The new enterprise must emerge itself as a customer-satisfying and customer-producing organism.

The incubation centre provides the needed impetus to new enterprises to succeed and grow.

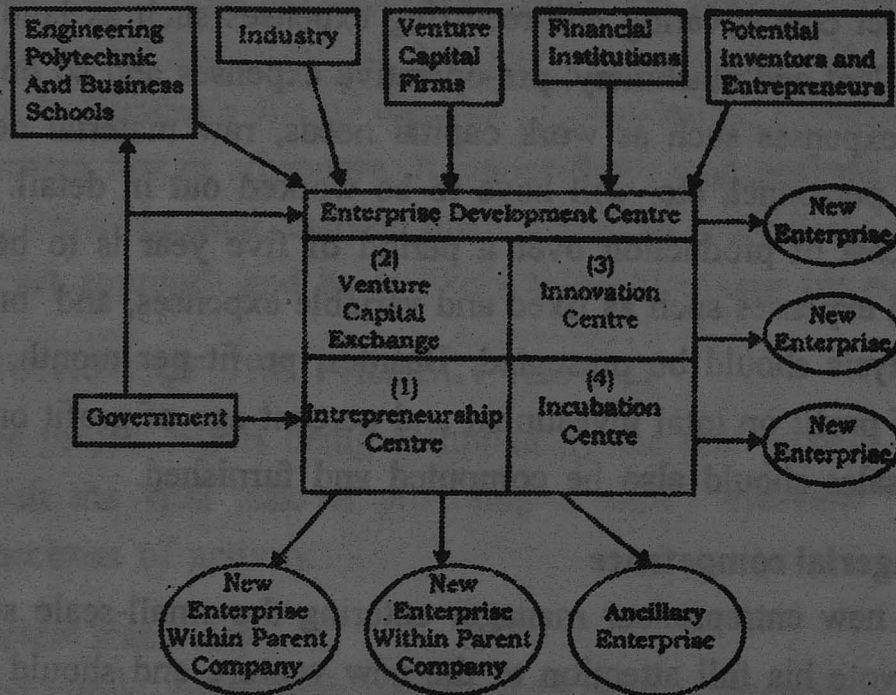


Fig. 1.5

Feasibility Report

Before starting a small-scale industry, one should consult the Director of Industries and the Small Industries Service Institute (SISI) located in one's State. The SISI guides entrepreneurs as to the type of industry to start, where to start and how to start it. The SISI helps them to select the various items of manufacture which have scope for development in the different areas. It suggests the lines on which project reports for the proposed units should be prepared for the consideration of the various financial institutions with a view to securing financial assistance. Similarly technical guidance in the selection of proper raw materials and type of machinery is also provided. Apart from this, the SISI gives valuable in-

formation on the various incentives available to the small-scale industries from the various organisations.

GAUGING THE INVESTMENT ENVIRONMENT

Survey participants identified the following criteria for rating foreign investment environments, though the relative position of each one on the priority scale varies according to the nature of a company's business. While portfolio investors tend to emphasize immediate bottom line issues like rates of return and remittability of profits, manufacturers with long-term investor horizons play up market potential and operating conditions. Nevertheless, all executives consider these four items critical to their companies, investment decisions.

- * Sound macroeconomic management: This included harmony between a country's fiscal and monetary policies a budget that is under control, relatively low or declining inflation, exchange rate stability, and an independent central bank free to hike interest rates as needed to control inflation and bolster the value of the country's currency.
- * A large local market to warrant the capital commitment, as well as long-term business opportunities. Investors would like to see the government freeing up previously state-owned sectors via a policy of privatization or deregulation.
- * Serious profit potential and remittability of profits and capital. The ability to earn an acceptable return consistent, with long-term goal is at or near the top of most investor priori-

ties. So is a fair tax system.

Adequately developed infrastructure: This included telecommunications, highways, ports, airports, electric power generation and distribution, coupled with availability of raw materials and other production inputs either from local sources or foreign markets-with the later subject to moderate important tariffs.

A project feasibility analysis includes market analysis, technical analysis, financial analysis and social profitability analysis. Although every feasibility analysis is different and is tailored to suit the product, its goal is to identify the strengths and weaknesses of the project.

The starting point of a project analysis is the establishment of the objectives to be attained. The next state is the pre-selection stage the advisability of having an in-depth study. The analysis stage consists mainly of three factors- market, technical and financial analyses. A market analysis is a method of screening project ideas as well as a means of evaluating a projects feasibility in terms of the market. A market analysis should cover the following areas.

- (i) A brief description of the market, including the market areas, methods of transportation, existing rates of transport, channels of distribution, and general trade practices.
- (ii) An analysis of past and present demand, including the determination of quantity and the rate of consumption, and identification of the major consumers of the product.

- (iii) An analysis of past and present supply, broken down as to source (whether imported or domestic), as well as information which will assist in determining the competitive position of the product, such as the selling prices, quality and marketing practices of the competitors.

The technical analysis of a project feasibility study establishes whether the project is technically feasible or not, and whether it offers a basis for the estimation of costs. Moreover, it provides an opportunity for the consideration of the effect of various technical alternatives on employment, ecology, infrastructure demands, capital service, support of other industries, balance of payments, and other factors. A technical analysis should contain a review of the techniques or produces to be applied and should incorporate.

- (i) A description of the product, including specifications relating to its physical, mechanical, and chemical properties, as well as uses of the product.
- ii) A description of the selected manufacturing processes, showing detailed flow charts and presenting the alternative processes which may have been considered and the justification for the adoption of the selected process.
- iii) A determination of the plant size and production schedule, which includes the expected volume for a given time period on the basis of start-up and technical factors.
- iv) Selection of machinery and equipment including specifications, equipment to be purchased and its origin, quotations

from suppliers, delivery dates, terms of payment, and a comparative analysis of alternatives in terms of cost, reliability, performance, and spare parts availability.

- v) An identification of plants location and an assessment of its desirability in terms of its distance from raw material sources and markets. For a new project, this part may include a comparative study of different sites, indicating the advantages and disadvantages of each.
 - vi) A design of the plant layout and an estimate of the cost of the erection of the proposed buildings and land improvements.
 - vii) A study of the availability of raw materials and utilities, including a description of physical and chemical properties, quantities needed, current and prospective costs, terms of payment, location of sources of supply, and continuity of supply.
 - viii) An estimate of labour requirements, including a detailed breakdown of direct and indirect labour requirements, and the supervision required for the manufacture of the product.
 - ix) A determination of the type and quantity of waste to be disposed off together with a description of the waste disposal method, its costs, and the necessary clearance from proper authorities.
 - x) An estimate of the production cost of the product.
- In the financial analysis of a project feasibility study, the

emphasis is on the preparation of financial statements, so that the project may be evaluated in terms of the different measures of commercial profitability and the magnitude of financing required may be determined. The financial analysis requires the assembly of the market and technical cost estimated in various proforma statements. If it is necessary to have more information on which to base an investment decision, a sensitivity analysis or, a risk analysis may be conducted. The financial analysis should include.

- (i) For projects that involve new companies, statements of total project cost, initial capital requirements, cash flow relative to the project time-table.

For all projects, financial projections for future time period, including income statements, cash flows, and balance sheets.

- ii) For all projects, supporting schedules for financial projection, stating the assumption made as to the collection period of sales, inventory levels, payment of production cost selling, administrative, and financial expenses.
- iii) For all projects, a financial analysis showing returns on investments, returns on equity, break-even volume, and price analysis.
- iv) For all projects, if necessary, a sensitivity analysis to identify items which have a substantial impact on profitability or possibly a risk analysis.

For the small entrepreneur, the studies conducted during the analysis stage of the project provide the material for as assessment.

If positive results are obtained, the entrepreneur, in seeking finance, will want to prepare an investment proposal. The planners or government officials, however, having obtained positive conclusions from the economic feasibility study, will want to evaluate the element of social profitability.

The purpose of the investment of loan application is to convince a lender (financial institution) that the project is a desirable investment, that it not only possesses the potential for profit but that the proposed management team has the capability to achieve the potential. The investment proposal normally contains,

- i) General information on the product, company history, the nature of the industry and the reputation and qualifications of the existing or proposed management.
- ii) A description of the project, which usually consists of extracts from economic feasibility studies and includes information on such items as market, production, selected manufacturing methods, (with detailed indication of the cost of equipment and operational expenses), and a financial statement.
- iii) Miscellaneous information, such as the steps taken for the implementation of the project and qualifications of the technical partners envisaged or selected.

Project Appraisal

After the form has been received, it is quickly scrutinised by the technical/appraising officials and the entrepreneur is called for a personal

interview in ABC Classification meeting. This meeting is held every week and conducted by a senior officer of the Corporation, where all the appraising officials are present. The project of the entrepreneur is discussed in detail. If the project is in the banned list then the application is returned to the entrepreneur.

Depending upon the documents given by the entrepreneur, the project is categorised as 'A', 'B' and 'C'. The proposal where requisite information is substantially complete is categorised as 'A' whereas the proposals where some more information is required to be submitted are categorised as 'B' and applications which are incomplete and substantial amount of information about the project is lacking are categorised as 'C'. The purpose of this meeting is basically to accord priority to the projects depending upon the completeness of the information submitted by the entrepreneur and explain personally the incomplete portion of the application. This meeting also gives an opportunity to assess the managerial capability of the entrepreneur.

Loan application are further processed as follows.

Technical Appraisal

- * Building requirement
- * Infrastructure facilities
- * Manufacturing process
- * Technical know-how
- * Installed capacity
- * Adequacy of plant and machinery and equipment

- * Availability of raw material.

Financial Appraisal

Financial appraisal involves the examination of financial soundness of the project in the following aspects.

- * Estimated cost of the project.
- * Means of financing the project.
- * Projection of future profitability; cash flow, internal rate of return, debt service coverage, debt equity and break-even analysis.
- * In case of expansion, modernisation and shifting of existing units from non-conforming to conforming areas, an analysis of the working results of the existing units, balance sheet and cash flow for the last three years etc.
- * Analysis of financial statements of past three years in case proprietor / partners / promoters are involved in other sister/associated concerns.

Economic Appraisal

Economic appraisal of the project involve the examination of the economic viability of the project in the following aspects.

- * Market potential, sales promotion
- * Employment potential.
- * Various permissions from Government and other authorities (local bodies) etc.

Managerial Capability.

This include the examination of the following.

- * Professional qualification of the following.
- * The promoters / entrepreneurs past industrial and business experiences.
- * Availability of skilled pattern etc.

After completing the above process of appraisal, the propos^{er} is placed before the competent authority for considerations.

**PARTICULARS OF ENCLOSURES TO BE SUBMITTED BY
THE APPLICANTS ALONGWITH THE APPLICATION FORM**
(Photostat/Attested Copies to be submitted)

HISTORY AND CONSTITUTION

1. (i) For partnership Deed on non-judicial stamp paper duly signed by all the partners. In case there have been some chances in the past in the constitution, previous partnership deeds and dissolution deeds also have to be attached.
- b) partnership to be registered under the Indian Partnership Act 1932 and Certificates of Register of Firms in Form 'A' (Statement of Particulars) & Form 'A' (Acknowledgment) to be sent.
- ii) For companies
 - a) Memorandum and Articles of Association of the company duly certified by the chairman of the company or two directors authorised in this behalf under the seal of company.

- b) Certificate of incorporation.
- c) Certificate of commencement of Business.
- d) Resolution of the Board of Directors authorising any two directors to make application for loan to Delhi Financial Corporation /Bank and sign loan application forms and other papers.

iii) For co-operative Industrial Societies.

- a) Bye - Laws of the society.
- b) Resolution of the managing Committee authorising two of the Office Bearers to make application for loan to Delhi Financial Corporation/Bank and sign loan application forms and other papers.

2 Brief note on the background of the concern and its promoters along with their biodata.

3. Financial Status

- a) balance sheet together with trading and profit and loss accounts for the last three years (Latest balance sheet should be duly audited by a chartered Accountant in case the loan assistance applied for exceeds Rs. 2 Lakhs)
- b) Proforma Balance sheet and profit & Loss Account as of the recent date, if the last balance sheet is more than six months old.
- c) Balance sheet, trading and profit & Loss account statements of the sister /associate/subsidiary concerns as well as of the concerns in which the proprietor, any of the part-

ners/directors is interested.

d) List of Sundry Debtors & Creditors,

e) List of secured, Unsecured Loans, Deposits, Loans & Advances

f) Income Tax, Wealth Tax Assessment orders for the last two years of the concern.

g) Income Tax/Wealth tax assessment orders for the last two years of the proprietor/partners/Directors etc.

4. Copy of the letter sent to the bank(s) authorising it to discuss the D.F.C. the concern's affairs and to disclose such information of furnish such statements as the D.F.C. may request it.

5. Land

Following papers issued by D.D.A/ Other Competent Authority

a) Allotment letter

b) No - Objection Certificate

c) Possession Certificates

d) Sale/Lease deed / Rent Deed

e) Site plan

f) Registration Certificate issued by the sub-registrar

6. Building

a) Affidavit of the Landlord in the case of rented premises as per form prescribed by the corporation

b) Lal Dora certificate from the competent authority if the premises are situated in the abadi area of a village.

- c) Lease deed/rent deed.
- d) Latest Rent receipt
- e) A set of plans of the existing / proposed factory building.
- f) Letter of approval of proposed building construction.
- g) Detailed estimate from a Registered Architect/Civil engineer regarding the proposed construction.

7. Plan and Machinery

- a) List of existing machinery
- b) List of proposed machinery
- c) Layout chart of existing & proposed machinery
- d) Process-flow chart & machine loading chart
- e) A detailed note on the manufacturing processes.
- f) Import Licence/Essentiality Certificate in respect of imported machinery.
- g) Latest quotations from at least two/three different manufacturers of repute in respect of imported machinery
- h) Latest quotations from at least two/three different manufacturers of repute in respect of indigenous machinery.

8. Raw Material

- a) Latest Import Licences / Essentiality certificates, if the raw materials is imported
- b) Quota allotment letters in case of indigenous raw material.

9. Power and Fuel

- a) letters of sanction of power load
- b) Allotment letter in respect of scarce items like coal & furnace oil.

10. Demand and market

- a) A note regarding demand & prospects of sale of the products.
- b) Particulars of principal customers, orders in hand and assurance letters.
- c) Particulars of sales organisation.

11. Licences

- a) Municipal Licence
- b) Licence under Factories Act.
- c) Registration as Small Scale Industry with the Directorate of industries.
- d) Licence under Industries (Development & Regulations) Act.
- e) Licence/permission for setting up the Cold Storage, / Ice Plant/Food processing unit.
- f) Any other licences/approvals.

Review questions.

1. What is a project ?
2. What are the various type of projects ?
3. What are the steps in project planning process.
4. Explain technical appraisal financial appraisal & Economic appraisal of a project.

5. What is business ? How does business of today differ from that of four to five decades ago ?
6. What are business goals ?
7. "Profit making is the primary goal of any business enterprise".
Yes or no - discuss.
8. What is business environment ?
9. "Firms which systematically analyse and diagnose the environment are more effective than those which don't. Elucidate.

Review questions

1. What is a project ?
2. What are the various types of projects ?
3. What are the steps in project planning process ?
4. Explain technical appraisal, financial appraisal & economic appraisal of a project.

UNIT - 2**PROJECT PLANNING****Introduction**

Project planning is emerging as an important area of project management. Project planning will cover all aspects relating to an enterprise. Broadly, planning implies comprehensive and co-ordinated activities in all facets of an enterprise and is aimed at the acceleration of development. Herein macro and micro planning are blended to ensure the success of the project. It, therefore, involves commitment at all levels to the development ideal. Project planning is a process involving the joint effort of a team of entrepreneurs, technicians and skilled workers. A planned project is a tool to achieve the objectives of the project at a minimum cost.

In an age of perpetual change, planning presents a special problem for business. For example, how do you plan a product with a five-year lead time ? And with markets changing and competition intensifying almost daily, how do you plan and develop systems to guide your company through the present and on to the 21st century ?

Business only answer is to plan for change as a way of life. Rather than making only occasional and drastic course corrections, business must now get out in front of the change curve and lead change rather than follow it. Business must invent a whole new concept of itself. It must see itself not land bound by tradition and predetermined plans but rather flowing along with the river of change.

It must work with nature, not against it. It must make progress by changing the very essence of the enterprise, by creating new opportunities and by creating its own future.

Having an effective plan for crisis is usually about 90 percent of the solution to that crisis. But getting ahead of the change curve doesn't mean that business people must make advance plans for each and every contingency. You can go broke buying insurance. And you can paralyze an institution with too much planning.

Steps in Business Planning.

The basic job of the entrepreneur is to conceive business visions and turn them into business realities. Vision has two parts. The first is the intuitive discovery of a potential business pattern - involving so called "right brain" activities. The second part of building a vision is the often tedious yet crucial work business planning. In business planning, you convert your intuitive vision into an action plan. The two parts of vision cannot be done sequentially. The task alternates rapidly between the creative-thinking up ways the business could unfold - and the analytical - figuring out the concrete implications of the intuitive vision.

Business planning documenting as best as you can everything that is important to the business, such as.

- * Your destination.
- * The strategies for getting there.
- * Where you would like to be at specific times.

- * The obstacles you may encounter
- * The approaches you plan to use in overcoming these obstacles.

Uses of a Business Plan

Many people think of a business plan as a tool for raising money or getting corporate approvals. Actually, its value as selling tool is a small part of the value of business planning. The benefits of the planning process include training yourself to become more entrepreneurial, screening your ideas, attracting a venture team, building team consensus, as well as getting the money and permission to proceed.

Business Plan Outline

Convert Sheet

Name of business

Names of principles

Address and telephone number of business

Statement of purpose (executive summary)

Description of business - product of service

Business structure

Description of

Amount of money being requested

How funds will be used

How funds will be repaid

Marketing plan

- The industry
- Competition
- Market size and opportunity
- Market segments served
- Marketing mix
- Key factors to success in market

Financial plan

- Sources and application of funds
- Capital equipment list
- Balance sheet
- Break-even analysis
- Income statements
- Pro-forma cash flow statements

Organizational plan

- Location of business
- Organizational structure
- Management
- Non-management personnel

Summary

- Application and expected effect of loans on business.

Supporting documents (as require)

- Personnel resumes
- Job descriptions

- Credit reports
- Letters of reference
- Copies of contracts
- Copies of leases
- Copies of letter of intent
- Legal documents
- Production requirements

Right Thing at the Right Time

The success of a small-scale industry solely depends upon one's doing the right thing at the right time. In other words, a small-scale industrialist has to be conversant with the varied regulations governing the small-scale industry and the procedures to be followed in order to acquire the necessary assistance and incentives offered by the government from time to time.

The procedural aspects of small-scale industry are quite formidable. Each and every entrepreneur is often overwhelmed by the multitude of procedures he has to face at every stage of the development of a small scale industry. It is, therefore, necessary to emphasise here that the student should concentrate more on the purpose and the principles underlying the various procedural formalities than on such routine formalities as filling in various forms, applications, etc.

In this chapter, the treatment of procedures - right from conceiving a small-scale industry until the repayment of creditors and ploughing back of profits-is based on the personal and practical.

experience of a small industrialist. In the latter part of the discussion, a reference has been made to the varied regulations that a small - scale industrialist has to abide by.

A discussion of the relevant procedures to be followed when setting up a small-scale industry has been dealt with. With reference to the various phases of its development. These phases are.

1. Selection of a small industry and preparation of feasibility and project reports.
2. Accommodation, power and other infrastructural facilities,
3. Machinery
4. Raw materials
5. Finance
6. Marketing, and
7. Securing various incentives offered for the establishment of small-scale industry.

Stated in simple terms, planning is a technique of organising, developing and controlling business activity in a systematic manner. But surprisingly, enough, we more often hear of conscious planning in social activities rather than in business life. In business/industries, people are, by and large, hesitant to plan because of.

- a) The uncertainties inherent in the everchanging economic environment which very often renders planning hazardous, if not meaningless.
- b) The lack of professional management
- c) The tendency of businessmen to follow the rule-of-thumb

method and

- d) The absence of a comprehensive and reliable management information system.

However, these are precisely the reasons which make the use of this technique imperative. Indeed, the greater the uncertainty, the greater is the need for planning and the benefits from planning would be extensive because an entrepreneur's response to change can be quicker. It is said "Today is the Product of yesterday's decisions, and the future that we plan today affects the present".

Conscious planning is necessary for survival in industries in which capital commitments are heavy and financial risks high, and which necessitates heavy research and development expenditure in an environment of acute competition and fast changing market preferences and consumer tastes.

Situation Appraisal

A situation appraisal is concerned with an evaluation of the ability of a small-scale unit to perform the essential tasks of the business in which it wishes to specialise. It searches the whole spectrum of the small-scale industry to identify its strength and weakness in terms of opportunities and threats indicated by environmental analyses. Some major areas to be examined include management, organisation, lines of service, production schedules, geographic presence, pricing strategy, sales promotion and management, human resources and systems support. Each of these areas can be examined for efficiency, effectiveness, integration within the organisation, and the external image it would project of the unit.

A second aspect of a situation appraisal is an examination of the current financial performance of small industries. Each department and division must determine where it stands and how its position has been achieved. Data should first be collected on major categories of assets and liabilities, such as loans, deposits, total assets, earning assets and equity. The collection of data then leads to simple analytical measures, such as the rate of growth and stability to be achieved.

ANALYSIS

(1)

1. EXTERNAL ENVIRONMENT - MARKET, COMPETITION CUSTOMER NEEDS
2. INTERNAL ENVIRONMENT- OUR STRENGTHS, OUR WEAKNESSES

SETTING MISSIONS - STATEMENT OF BUSINESS, FUNDAMENTAL SOCIO- (2)
ECONOMIC OBJECTIVES

PLANNING PREMISES OR ASSUMPTIONS IN WHAT EXTERNAL AND (3)
INTERNAL ENVIRONMENT WILL OUR PLANS OPERATE ? FORE
CASTING THE FUTURE

INTELLIGENT SEARCH OF OPPORTUNITIES - MOST PROMISING (4)
ALTERNATIVES OF FULFIL OUR OBJECTIVES UNDER THE SITUATIONAL
FORECASTS - ECONOMIC, SOCIAL, TECHNOLOGICAL, POLITICAL

COMPARISON AND EVALUATION OF ALTERNATIVES IN LIGHT (5)
OF OBJECTIVES SET - ON THE BASIS OF COSTS - BENEFIT ANALYSIS

PICKING UP A FEW BEST ALTERNATIVES TO BE
PURSUED IN ORDER OF PRIORITY (6)

← DECISION-MAKING POINT

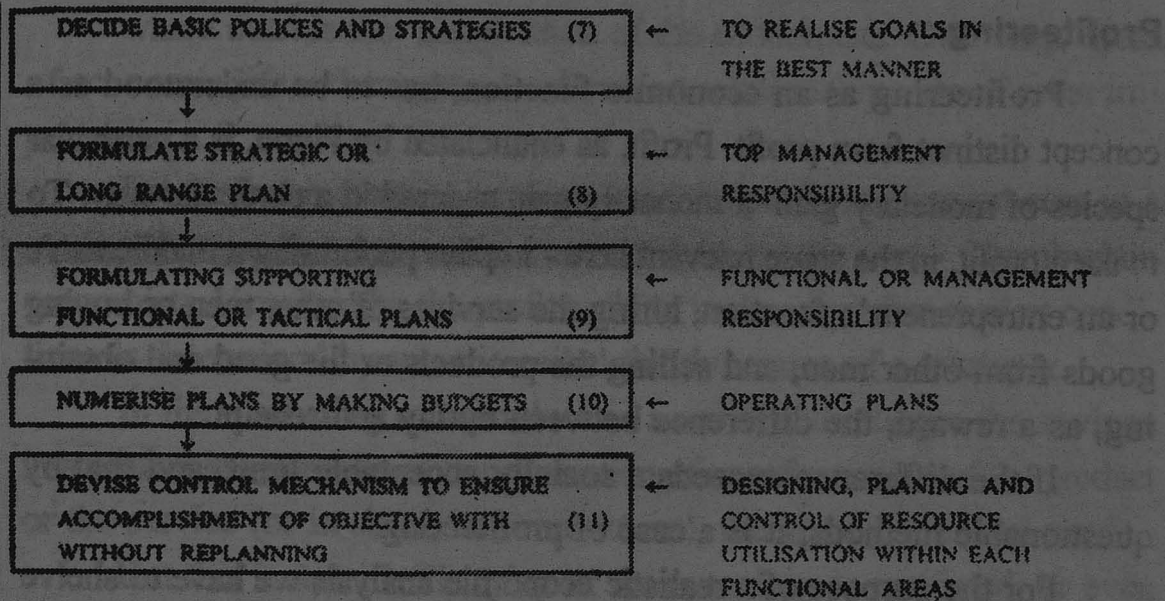


Fig. 2.1 Steps in Project Planning Process

The next step is to develop market share for this purpose, it would be useful to build a comparative data base from a panel from a panel of small-scale industries considered to be competitive in various markets and product. The position of the small-scale industry in each major area for which financial objectives have been stated is then compared with that of the small-scale industries in the panel for compound growth rates over the past five years. Such comparisons will indicate whether others in similar circumstances have been able to achieve the desired results, and whether the objectives are realistic.

On the completion of the environmental analysis and situation appraisal, the results should be assembled into a set of statements which describe the current position of a small-scale industry. It is now possible to study today's objectives and strategies as a major step in the process of translating the objectives and strategies which will guide the future development of a small-scale industry.

Profiteering

Profiteering as an economic function, has to be understood as a concept distinct from profit. Profit, as enunciated by Pigou, is a particular species of monetary gain- a monetary gain secured in a particular way. To make a profit, in the sense relevant here - implies performing a middleman's or an entrepreneur's function, hiring the services of other men or buying goods from other men, and selling the products or the good and obtaining, as a reward, the difference between outlay and receipt.

If the difference exceeds a socially acceptable limit, and that by questionable methods, it is a case of profiteering.

For the purpose of a realistic economic analysis we have to shelve the principles governing perfect market competition, and have to reckon with the forces of imperfect competition, duopoly, monosony and oligopoly, monopolistic competition and black market.

Before we analyse the economic process of profit-making and, in that context, the theory of maximisation, and finally of profiteering, it is necessary to appreciate that it would no longer suffice to assume merely that the demand and supply curve exist, and that some are elastic and some inelastic, or that some rise and some fall. If we do not so appreciate it, we shall reduce the study of economic phenomena of today's market situation to the simplicity of the concept of bilateral trade.

The assumption of perfect competition on which much of the supply and demand analysis is based must also be scrutinised. Perfect competition is rare- and; in a real sense, does not exist any

where outside the imagination of the economists. Over large areas of economic life, other systems of market relationships are of great importance.

Let us first indicate the principle of the profit-making process in a market of imperfect competition, as was done by the post - Chamberlain economists. Very briefly, the profit-making under imperfect market conditions is determined by what is called the dynamics of a marketer.

In the marketing of a product or a service, the larger the savings in a profitable succession of transformation of transformations of the product or the service (or in short, the investment), the greater the total profit.

But this is not all. The play of these savings is restricted, or even determined, by the nature and extent of market imperfection and the presence and delineation of risks and uncertainty.

According to the theory of profit optimisation, marginal conditions in the market will lead to optimisation of production in relation to its total marketable cost components, so that the maximum average revenue for minimum average cost is achieved. In any case, this will be one of the ends of the economic functions of a marketer under imperfect competition in his endeavour to optimise profit.

Profit maximisation, or profiteering, is conditioned by the "principle of increasing risk and uncertainty", as Kalecki calls it. With an increase in the potential of risks on the investment co-efficient, profits will increase or decrease to the extent of the risk that is taken.

In the long run, a small industry can survive only if it can

make enough profit to pay a return on the capital after making adequate and necessary provisions. Profit, is the outcome of the operations of all small scale industries and, in the ultimate analysis, of profit planning. Profit can be expressed as an earning per share, a return on the capital employed or a return on a shareholder's capital. There are difficulties in expressing all the three and in making comparison with the competitors in the field.

It has now been recognised that the old theory of profit maximisation is not strictly valid in the present - day Indian context because of the developmental role which the small-scale industry is called upon to play in the context of its socio-economic obligations, although in the long run it has to be a profitable proposition if it has to survive in the fiercely competitive world of today. The central objective, therefore, should be a judicious combination of profit with achievements on the socio-economic front. Some economists refer to this as profit with growth. For our purpose, we shall assume that what small-scale industries are primarily striving for is improved profitability rather than maximisation of profit as an end in judicious combination of profit with achievements on the socio-economic front. Some economists refer to this as profit with growth. For our purpose, we shall assume that what small-scale industries are primarily striving for is improved profitability rather than maximisation of profit as an end in itself.

Operational guidelines form the basis or the cornerstone of an operational plan to be formulated at the branch level, or what is known as the performance budget. The final operational plan that

emerges from the aggregation of the performance budgets of the various branches should give a clear picture of what the small-scale industry is expected to become in terms of assets and liabilities, revenue and expense, at the end of the period under review, supplemented by a statement of cash flow.

Implementation of Plans

Plans have no meaning if they are not implemented. Control, therefore, becomes an integral part of the planning process, and for control to be effective, the management should constantly know in an organised and systematic manner, how closely the action follows the plan, and to do whatever is needed to bring performance in line and with the plan. It is the variance from the plan which signals the need for corrective action and this ought to be achieved through an efficient system of management information and monitoring of feedback information.

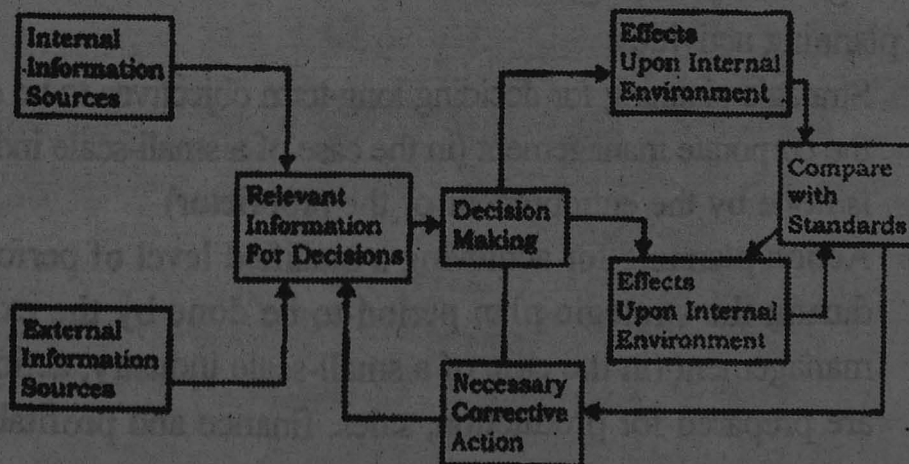


Fig 2.2

whatever is needed to bring performance in line and with the plan. It is the variance from the plan which signals the need for corrective action, and this ought to be achieved through an efficient system of management information and monitoring of feedback information.

In other words, corporate planning combines in the systematic, integrated and formal way, strategic, tactical operational and projects planning over a period of years. It has often been described as a "coordinated and cohesive set of strategic, tactical and operational guidelines" or decision rules, quantified, as far as possible, in financial terms, by which an organizations seeks to attain its short and long term objectives within the limits of its available and, one might add, "attainable" resources. Corporate planning is scientific because it defines and quantifies objectives, analyses facts, and sets performance standards to reach the objectives. The results are reviewed periodically, and timely remedial action is taken if and when called for.

Management planning, on the other hand, falls into three distinct types of planning activities.

- a) Strategic planning for deciding long-term objectives-to be done by the corporate management (in the case of a small-scale industry, it is done by the entrepreneur or the proprietor)
- b) Action planning for achieving a qualified level of performance during the strategic plan period-to be done by the executive management (in the case of a small-scale industry, action plans are prepared for production, sales, finance and profitability).

- c) Operational planning for developing performance targets for a much shorter period, usually one year, in order to provide effective tools for management control - to be done in consultation with the operating management, i.e., the marketing department, the finance section, etc.

Here some very valid questions arise.

- i) How much do we change our style of management to enable every level of management - indeed, every member of the staff to contribute ?
- ii) Is the organisational structure appropriate to the objectives ? Will it stand the typical stresses and strains, and does it offer maximum freedom and flexibility in which one may perform ? Are responsibility areas clearly defined in realistic and workable manner in accordance with the need for the generation of revenue and/or expenses ?
- iii) Is the formation structure appropriate, and does the revenue and/or expense reporting system follow responsibility areas so that managers may measure their performance and judge and control themselves ?
- iv) Is there a fair basis for fixing the prices for the transfer of services and funds among the different responsibility areas ?

These are vital matters involving a great deal of work, the implications of which cannot be considered here.

Planning Machinery

A word about the planning machinery. Planning is not the task of a functional department, it must be initiated at the top (small

entrepreneur) and is an important part of every "line" manager's job. The planning staff is not paid to do the "line" manager's thinking, its function is advisory analysing opportunities, studying the effects of environments, and coordinating. It may sometimes be more important that they know a lot about planning than a lot about the technical aspects of a small-scale industry. They help to set up a decision-making process, but do not take the decisions. The planner is a kind of a pilot aboard a ship, he does not decide the destination, but he helps to set the course which the master of the vessel has decided upon.

Planning is a primary function of entrepreneurial management. It is a bridge between the present and the future. It gives entrepreneurs some purpose, objectives, programme direction towards the goals. Planning is deciding in advance what is to be done. It is primarily concerned with looking into the future, involving the selection of and the best alternative.

Planning is a best tool for small-scale enterprises to look into the future and meet the challenges and emerge victorious in milieu. Planning is, therefore, the first and primary function of small-scale entrepreneurs. Thus, planning logically precedes the execution of all other functions of an enterprise.

The process of planning helps the small-scale entrepreneur to regulate his production, sales and administrative cost, and to maximise his profit. The perspective outlook as a lever for efficient management and lays down a strong foundation for accelerated growth. Further, it enables the entrepreneur to plan for the expansion of his unit.

INDUSTRIAL POLICY

Once of the components of economic environment is the industrial sector. As the economic environment is largely influenced by the industrial production, it is useful to discuss all its related aspects. The aspects covered here are industrial policy, industrial licensing, regulation of trade practices harmful to public interest, regulation of foreign exchange, regulation of companies, industrial labour, public sector enterprises, SSI sector, industrial sickness, privatisation and the like. This and the next couple of chapters are devoted for a detailed discussion of all these.

Industrial policy is an important document which lays a wide canvas and sets a tone for implementing promotional and regulatory roles of the government. A discussion of the industrial policy is desirable before describing economic environment. This chapter is devoted for the purpose.

The term "industrial policy" refers to government's policy towards industries - their establishment, functioning, growth and management. The policy will indicate the respective areas of the large, medium and small-scale sectors. It will also spell out government's policy towards foreign capital, labour, tariff, and other related aspects. Naturally, the industrial development of a country will be shaped, guided, fostered, regulated and controlled by its industrial policy.

Industrial policy probably the most important document which indicates the relationship between government and business. The

document is helpful to planners and administrators in the government, in as much as it gives clear guidelines for promoting and regulating industries. It is equally helpful to industrialists and others for deciding areas and priorities of their investments.

The industrial policy has no legal sanction and as such its violation cannot be challenged in a court as is possible in the case of fundamental rights guaranteed by the constitution. However, it has certain broad guidelines for government's administrative action and deals with only the qualitative aspects thereof. There are no physical targets to be fulfilled, no time-span, no financial commitment as in the case of an industrial plan. There is only a moral commitment on the part of the government to implement the policy in word and spirit.

Rationale

Yet, industrial policy has strong justification for its existence. For example, it can.

1. Correct the imbalances in the development of industries and help bring about a desirable balance and diversification in them.
2. Direct the flow of scarce resource in the most desirable areas of investment in accordance with national priorities.
3. Prevent the wasteful use of scarce resources and ensure their convection and judicious utilisation.
4. Empower the government to regulate the establishment and

expansion of private industry in accordance with the planned objectives.

5. Demarcate areas among the public, private and joint sectors of the economy, as well as large, medium and small scale industries.
6. Prevent, through fiscal and monetary policies, the formation of monopolies and concentration of wealth in a few hands so that the evil associated with monopolies can be effectively curbed.
7. Give guidelines for importing foreign capital and the conditions on which such capital should be permitted to operate.

INDUSTRIAL POLICY, 1991

On 24th July 1991, the government headed by Mr. P. V. Narasimha Rao announced a new industrial policy which seeks to drastically alter the industrial scenario in our country. There are several fundamental departures in the new policy. The most important initiatives are with respect to the virtual scrapping of industrial licensing and registration policies, an end to the monopoly law and a more welcoming approach to foreign investment, apart from redefining the role of the public sector. These measures, long overdue, are welcome as they would free industry from regulations most of which have outlived their utility.

Objectives

Succinctly the objectives of the New Industrial Policy are:

- i) Self-reliance to build on the many sided gains already made.
- ii) Encouragement to Indian entrepreneurship, promotion of productivity and employment generation
- iii) Development of indigenous technology through greater investment in R & D and bringing in new technology to help Indian manufacturing units attain world standards.
- iv) Removing regulatory system and other weaknesses.
- v) Increasing the competitiveness of industries for the benefit of the common man
- vi) Incentive for industrialisation of backward areas.
- vii) Enhanced support to small-scale sector
- viii) Ensure running of public sector undertakings (PSUs) on business lines and cut their losses.
- xi) Protect the interests of workers
- x) Abolish the monopoly of any sector in any field of manufacture except on strategic or security grounds.
- xi) To link Indian economy to the global market so that we acquire the ability to pay for imports, and to make us less dependent on aid.

In pursuit of the above objectives, Government has decided to take a series of initiatives in respect of the policies relating to the following areas:

- A. Industrial Licensing
- B. Foreign Investment
- C. Foreign Technology Agreements

D. Public Sector Policy

E. MRTP Act

A package for the small and tiny sectors of industry is being announced separately. This policy will be discussed latter in this book.

A. Industrial Licensing Policy

Industrial licensing is governed by the Industries (Development & Regulation) Act, 1951). Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalised from time to time. A full realisation of the industrial potential of the country calls for a continuation of this process of change.

In order to achieve the objectives of the strategy for the industrial sector for the 1990 and beyond, it is necessary to make a number of changes in the system of industrial approvals. Major policy initiatives and procedural reform are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgment. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that

have become characteristic of today's industrial world. Government Policy and procedure must be geared to assisting entrepreneurs in their efforts. This can be one only if the role played by the Government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays.

The winds of change have been with us for some time. The industrial licensing system has been gradually moving away from the concept of capacity licensing. The system of reservation for public sector undertakings has been evolving to ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. This calls for bold and imaginative decisions designed to remove restraints on capacity creation, while at the same time, ensuring that over-riding national interests are not jeopardised.

In the above context, industrial licensing will henceforth be abolished for all industries, except those specified (13 in number) irrespective of levels of investment. These specified industries will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and overriding environmental issues, manufacture, of products, of hazardous nature and articles of elitist consumption. The exemption from licensing will be particularly helpful to the many dynamic

small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. As a whole, the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful place in the world of industrial progress.

B. Foreign Investment

While freeing Indian industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. In view of the significant development of India's industrial economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant change that have also taken place in the world industrial economy, the relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment. Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest will therefore welcome foreign investment which is in the interest of the country industrial development.

In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it has been decided to provide approval for direct foreign investment upto 51%

foreign equity in such industries. There shall be no bottlenecks of any kind in this process. This group of industries has generally been known as the "Appendix I industries" and are areas in which FERA companies have already been allowed to invest on a discretionary basis. This change will go a long way in making Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities. To the extent that expertise of this nature is not well developed so far in India, Government, will encourage foreign trading companies to assist us in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involve interaction with some of the world's largest international manufacturing and marketing firms. The government will appoint a special board to negotiate with such firms so that we can engage in purposive negotiation with such large firms, and provide the avenues for large investments in the development of industries and technology in the national interest.

C. Foreign Technology Agreements

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. In the fast changing world of technology the relationship between the suppliers and users of technology must be a continuous one. Such a

relationship becomes difficult to achieve when the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty. The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances for his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment.

With a view to injecting the desired level of technological dynamism in Indian industry, Government will provide automatic approval for technology agreements related to high priority industries within specified parameters. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free foreign exchange. Indian companies will be free to negotiate the terms to technology transfer with their foreign counterparts according to their own commercial judgment. The predictability and independence of action that this measure is providing to Indian industry will induce them to develop indigenous competence for the efficient absorption of foreign technology. Greater competitive pressure will also induce our industry to invest much more in research and development than they have been doing in the past. In order to help this process, the hiring of foreign technicians and foreign testing of endogenously developed technologies, will also not require prior clearance as prescribed so far, individually or as a part of industrial or investment approvals.

D. Public sector policy

The public sector has been central to our philosophy of develop-

ment. In the pursuit of our development objectives, public ownership and control in critical sectors of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good.

The Industrial Policy Resolution of 1956 gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which has a commanding role in the economy. Today key sectors of the economy are dominated by mature public enterprises that have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, overmanning, lack of continuous technological upgradation, and inadequate attention to R & D and human resource development. In addition, public enterprises have shown a very low rate of return on the capital invested. This has inhibited their ability to regenerate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilutions. The most striking example is the take over of sick units from the private sector. This category of public sector units accounts for almost one-third of the

total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of the public sector being at the commanding heights of the economy, is the plethora of public enterprises which are in the consumer goods and services sectors.

It is time therefore that the government shall adopt a new approach to public enterprises. There must be a greater commitment to the support of public enterprises which are essential for the operation of the industrial economy. Measure must be taken to make these enterprises more growth oriented and technically dynamic. Units which may be faltering at present but are potentially viable must be restructured and given a new lease of life. The priority areas for growth of public enterprises in the future will be the following.

Essential infrastructure goods and services.

Exploration and exploitation of oil and mineral resources.

Technology Development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate.

Manufacture of products where strategic considerations predominate such as defense equipment.

At the same time the public sector will not be barred from entering areas not specifically reserved for it.

In view of these considerations, government will review the excision portfolio of public investments with greater realism. This review will be in respect of industries based on low technology,

small-scale and non-strategic areas, inefficient and unproductive areas, areas with low or nil social considerations or public purpose, and areas where the private sector has developed sufficient expertise and resources.

Government will strengthen those public enterprises which fall in the reserved areas of operation or are in high priority areas or are generating good or reasonable profits. Such enterprises will be provided a much greater degree of management autonomy through the system of memoranda of understanding. Competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises. There are a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose.

These need to be attended to. The country must be proud of the public sector that it owns and it must operate in the public interest.

E. Monopolies and Restrictive Trade Practices Act (MRTP ACT)

With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the interference of the government through the MRTP Act in investment decisions of large companies has become deleterious in its effect on India's industrial

growth. The pre-entry scrutiny of investment decisions by the so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopoly houses to obtain prior approval of Central government for expansion, establishment of new undertakings, merger, amalgamation and takeover and appointment of certain directors. The thrust of policy will be more of on controlling unfair or restrictive business practices. The MRTP Act will be restructured by eliminating the legal requirement for prior government approval for expansion of present undertakings and establishment of new undertakings. The provisions relating to merger, amalgamation, and takeover will also be repealed. Similarly, the provisions regarding restrictions on acquisition of and transfer of shares will be appropriately incorporated in the companies Act.

Simultaneously, provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation suo moto or complaints received from individual consumers or classes of consumers.

In view of the considerations outlined above government has decided to take a series of measures to protect the Indian industrial economy from the cobwebs of unnecessary bureaucratic controls. These measures will be covered in appropriate places in subsequent chapters.

Merits of the 1991 Policy Statement

- 1) The 1991 Policy Statement is truly historic, whether it is the result of IMF pressure or our own realisation that the

time has come to open up the economy.

- 2) The changes long overdue, need to be welcomed as a bold initiative aimed at making Indian industry more competitive internally as well as internationally, and at freeing industry from needless and irksome controls, most of which have outlived their utility.
- 3) The delicensing of a host of industries and the abolition of all registration schemes will free Indian entrepreneurs from the need to make endless trips to New Delhi. They can now concentrate on their business and move quickly to seize business opportunities.
- 4) The scrapping of any asset threshold or market share prescription for the definition of an MRTP company and a dominant undertaking allows companies to go ahead with investment programme without delay.
- 5) The liberalisation of the rules relating to direct foreign investment, permitting 51 per cent equity in a wide range of industries, the easier facilitation of foreign technology agreements and other related measures go a long way in attraction foreign investment and technology.
- 6) Reforms relating to public sector like privatisation and transferring sick units to BIFR will help improve the performance of the government undertakings.
- 7) Finally, the now policy Statement is a most welcome package. There is greater reliance on the market, a bold attempt at deregulation, a desire to integrate with the world economy, and

to modernise.

Limitations of 1991 policy

- 1) Virtual scrapping of licensing means absence of a mechanism to determine priorities and to develop backward areas.
- 2) The policy is silent about tackling the growing industrial sickness. The government has not announced a clear exit policy or sick units. Clearly government seems to have yielded to the pressure of trade union lobby.
- 3) Off-loading of 20 percent equity in profit making public sector units to mutual funds is a revenue raising exercise than genuine attempt at privatisation.
- 4) Even with the scrapping of all regulations, the expected foreign investment may not come through. Infrastructural deficiencies will deter foreign investment.
- 5) The policy is drafted at the behest of IMF which means virtual surrender of economic sovereignty of the country to a foreign agency.

INDUSTRIAL LICENSING

Ours is one of the few countries in the world where an entrepreneur is required to obtain an industrial license from the government before venturing into a new business. This chapter is devoted to a brief description of the objectives the recent changes announced by the government and other related matters relating to licensing.

Objectives of Licensing

A licence is a written permission issued by the Central Government to an industrial undertaking stating such details as the location, the article to be manufactured, production capacity and other relevant particulars. It is also subject to a validity period within which the licensed capacity should be implemented.

The main objectives of licensing are:

- a) To limit industrial capacity, within the targets set by the plans
- b) To direct investment in industries according to plan priorities.
- c) to regulate the location of industrial units so as to secure a balanced regional development
- d) To prevent monopoly and prevention of concentration of wealth.
- e) To protect small-scale industries against undue competition from large-scale industries.
- f) to foster technology and economic improvement in industries by ensuring units of economic size and adopting modern processes, and
- g) To encourage new entrepreneurs to start industrial units thus broadening the entrepreneurial base.

The major objective of licensing is to give effect to the industrial policy of the Government. Any change in the industrial policy, therefore, will have its repercussions on licensing system.

Table gives details regarding the number of licences issued.

Figures do not mean much now because licensing itself has almost become irrelevant thanks to liberalisation programmes.

" Letters of intent issued and licences granted "		
	Letters of Intent	Licences
1984	1064	905
1985	1458	985
1986	1130	618
1987	961	524
1993	...	100

Legislative framework for licensing

The legislative framework for industrial licensing is provided in the in the Industries (Development and Regulations) Act, 1951).

INDUSTRIES (DEVELOPMENT OF REGULATIONS) ACT, 1951

The Act seeks to secure planned industrial development of the country by regulating, controlling and developing industries that are included in the First Schedule to the Act. Regulation of industries is sought to be achieved by means of registration of existing industrial undertakings, licensing of substantial expansion. Production of new articles, change of location of existing undertakings, etc. Control over these industries is sought to be achieved by causing investigation into the working of these industries and taking over of their management and control. Development of these industries, on the other hand, is sought to be secured primarily through the agencies of Central Advisory Council and Development Councils and by offering certain

facilities as the government may think fit to be necessary for the development of the scheduled industries.

Objectives of the Act

The Act has three important objectives, viz.

i) **Implementation of the Industrial Policy.**

The Act provides necessary means to the Central Government in order to implement its industrial policy.

ii) **Regulation and Development of Important Industries.** The Act brings under the control of the Central Government the development and regulation of a number of important industries listed in the First Schedule attached to the Act as the activities of such industries will affect the country as a whole and, therefore, the development of such important industries must be governed by the economic factors of all-India importance.

iii) **Planning and Future Development of New Undertakings,** A system of licensing is introduced under the Act to relate planning and future development of new undertakings on sound and balanced lines as may be deemed expedient in the opinion of the central government. The Act confers on the Central Government power to make rules for the registration of existing undertakings for regulating the production and development of the industries specified in the schedule attached to the Act. The Act also provides for the constitution of Central Advisory Council and Development

Council.

The following excerpt from "The Industrial Development of India, Policy and Problems" adds a new dimension to the objectives of the Act.

"Bringing industry within the purview of this Act has the effect of transferring from the States to the central Government the responsibility and power of legislation for its regulation, control and development. Since most industries were brought under this Act, something like a constitutional revolution took place in 1952 by virtually making industry a Central subject rather than a State subject as envisaged in the Constitution. This change, however, is of vital and fundamental importance to the building up and the preservation of the economic unity of the country.

Scope of the Act

The Act applies to the whole of India including the State of Jammu & Kashmir. The provisions of the Act apply to industrial undertakings manufacturing any of the articles mentioned in the First Schedule. An industrial undertaking (also called a factory) for the purpose of the Act is the one where manufacturing process is being carried on.

- a) With the aid of power provided that fifty or more workers are working or were working on any day of the preceding twelve months, or
- b) without the aid of power, provided that one hundred or

more workers are working or were working on any day of the preceding twelve months.

- c) The act applies only to industrial undertakings. Trading houses and financial institutions are outside the purview of the Act.

Provisions of the Act

The Act has thirty one sections and all of them can be classified into three broad categories, depending upon the purposes they seek to serve (See Fig.1)

A. Preventive Provisions,

Preventive Provisions Provide for.

- (i) Registration and licensing.

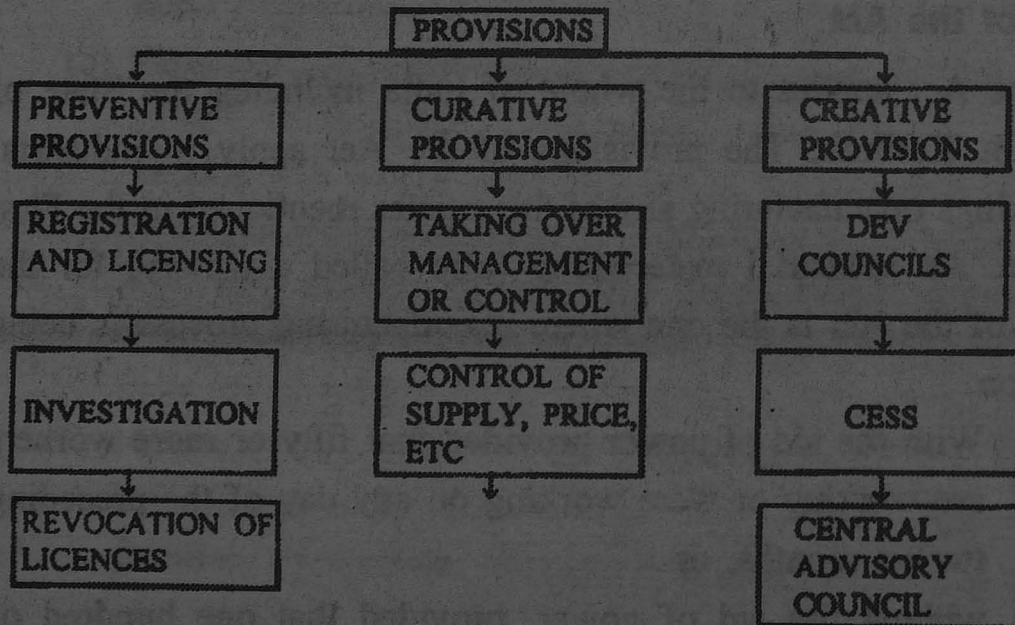


Fig. 2.3 Provision of I (D & R) Act

ii) Investigation, and

iii) Revocation of licence

i) **Registration of an Existing Undertaking.** Section 10 Provides that the owner of every industrial undertaking other than the central government shall get his undertaking registered within a specified period. The central government shall also cause to be registered every existing industrial undertaking of which the central government is the owner. On registration, the owner shall be issued a certificate of registration containing the production capacity of the industrial undertaking and other particulars.

In specifying the production capacity in the certificate of registration, the Central Government takes into consideration the following factors.

- i) The productive or installed capacity as specified in the application.
- ii) The level of production immediately before the date on which the application for registration was made.
- iii) The level of the highest annual production during the three years immediately preceding the introduction of an Amendment Bill to this Act in 1973.
- iv) The extent to which production during the said period was used for export, and
- v) Such other factors as may be considered relevant, including the extent of under utilisation of capacity, if any.

Registration Abolished : As a consequence to the new industrial policy, existing schemes of registration have been abolished.

Licensing of Undertakings : Licence is required for establishing a new undertaking, for manufacturing a new article by an existing undertaking, for effecting substantial expansion by an existing unit, for changing location of an existing undertaking and carrying on business by an existing undertaking.

a) *Licensing of New Undertaking :* Section 11 of the Act provides that no person or authority, other than the Central Government, shall establish, after the commencement of this Act, a new undertaking without a licence issued by the Central Government. A state government also needs a licence to set-up a new unit.

b) *Production of New Articles:* Section 11A provides that no owner of an industrial undertaking, other than the central Government, which is registered under Sec. 10 of this Act or licensed or permitted under Sec. 11 of this Act, shall produce or manufacture a new article without obtaining a licence to do so.

c) *Licence for Effecting Substantial Expansion :* Section 13 lays down that no owner of an industrial undertaking, other than Central Government, shall effect a substantial expansion of an undertaking which has been registered or licensed, without a licence issued to that effect by the Central Government. What is substantial expansion is not made clear in this Act. However, from the various notifications issued by the Central Government from time to time, it has been made clear that expansion up to 25 percent will be regu-

lated. In other words, expansion up to 25 percent will not be considered substantial.

d) Licence for shifting Location: Sec. 13 lays down that without obtaining licence to the effect, no owner can change the location of the whole or any part of industrial undertaking which has been registered.

e) Licence to Carry on Business: Licence is also necessary to carry on business (COB) by an existing undertaking to which licensing provisions of the Act did not originally apply on account of an exemption order issued by the government and subsequently became applicable as a result of cancellation of the exemption order under certain other circumstance as provided in the Act.

Licensing Abolished:

As per the government Notification No. 477 (E) dated July 25, 1991 issued under the Act, Section 11, 11 A and 13 have been made inoperative.

Investigation: section 15 empowers the Central Government to cause an investigation into an industrial undertaking on the happening of.

- a) a substantial fall, or likely fall in the volume of production in respect of any article or class of articles relating to particular undertaking or an industry, or
- b) a deterioration, or likely deterioration, in the quality of the product which could have been or can be avoided, or
- c) a rise, or likely rise (unjustifiable), in price of any article

or class of articles, or

- d) When it becomes necessary to take action for the conservation of any resources of national importance which are utilised by any undertaking, or
- e) where any industrial undertaking, scheduled or other wise, is being managed in a manner highly detrimental to the scheduled industry concerned or to public interest.

If the investigation proves that action is desirable, the Central Government will take necessary action under Sec. 16 of the Act. Sec. 16 of the Act provides that the Central Government may issue such directions to the industrial undertaking concerned as may be appropriate in the circumstances for all or any of the following purposes.

- a) Regulating the producing of any article or class of articles by the industrial undertaking or undertakings and fixing the standard of production.
- b) Controlling the price or regulating the distribution of any article or class of articles being the subject - matter of investigation.

Revocation of Registrations and Licence. Sec. 10 of the Act empowers the Central Government to revoke the registration when.

- a) registration was obtained by misrepresentation of an essential fact, or
- b) Undertaking has ceased to be registrable by reason of any exemption granted under the Act, or

c) Registration has become useless or ineffective.

Sec. 12 of the Act empowers the Central Government to remove or amend any licence granted for establishing a new undertaking, or licence granted for manufacturing a new article, on finding that the license has, without reasonable cause failed to establish or to take effective steps to implement the licence within the time allowed.

B. Curative Provisions

Curative Provisions include the following

- i) Taking over management or control and
- ii) Control of supply price and distribution of certain commodities.

Power to Take Over Management or Control. Sec 18 A of the Act Provides that the Central Government may by a notified order authorize any person or body of persons to take over the management or to exercise control over a specified industrial undertaking if the Central Government is of the opinion that

- i) the concerned industrial undertaking has failed to comply with the directions issued under Sec. 15 of the Act, or
- ii) the affairs of an undertaking, in respect of which an investigation has been ordered under Sec. 15 of the Act, are being managed in a manner highly detrimental to the scheduled industry concerned or public interest.

The period of take over was five years, to be extended further for a period of two years subject to a maximum of twelve years.

Power of Take Over Without Investigation, sec. 18 A provides for the take over after investigation. The Act, under Sec. A, also provides for the take over, without investigation, provided that the Central Government is satisfied, on the basis of any documentary or other evidence in its possession, that in relation to an industrial undertaking the persons in charge of such industrial undertaking have, by reckless investments or creation of encumbrances on the assets of the industrial undertaking or by diversion of funds, brought about a situation which is likely to affect the production of articles manufactured or produced in the industrial undertaking and that immediate action is necessary to prevent such situation, or industrial undertaking has been closed for a period of not less than three months and such closure is prejudicial to the concerned scheduled industry, and that the financial condition of the company owing the industrial undertaking and the condition of its plant and machinery makes it possible to restart the undertaking in the interest of the general public. The period to take over is to be five years, to be extended by a further period of two years, subject to the maximum of 12 years.

Take Over Management or Control of Industrial Undertaking Owned by Companies in Liquidation. Sec. 18 A empowers the Central Government to authorise any person or body of persons with the permission of the High Court concerned to take over the management or control of industrial undertakings owned by the companies in liquidation provided that the Central Government is of the opinion that there are possibilities of running or restarting such undertakings for maintaining or increasing the production, supply or distribution

of articles or class of articles in the public interest. The period of such take over is to be five years, to be extended six times of two years each.

Sec. 18 FA empowers the Central Government to sell the undertaking as a running concern or to reconstruct the same in the interest of the general public or in the interest of the shareholders of the company.

No state government or local authority can take over the management or control of a scheduled undertaking.

Power to Control Supply and Price of Certain Articles: In order to secure equitable distribution and availability at fair prices of any article or class of articles relating to any scheduled industry, the Central Government may, by a notified, order provide for regulating the supply and distribution thereof. The notified order may provide for:

- a) Controlling the prices at which any such article or class thereof may be bought or sold.
- b) Regulating by licence, permits, or otherwise the distribution, transport, disposal, acquisition, profession, use or consumption of any such article or class thereof.
- c) Prohibiting the withholding from sale of any such article or class thereof, ordinarily kept for sale.
- d) Requiring any person manufacturing, producing or holding any stock in such article or class thereof to sell the whole or part of the articles so manufactured or produced during

a specified period or to sell the whole or a part of the articles so held in stock to such person or class of persons in such circumstances as may be specified in the order.

- e) Regulating or prohibiting any class of commercial or financial transaction relating to such article or class thereof, which in the opinion of the authority making order, are detrimental to the public interest.
- f) Requiring persons engaged in the distribution and trade and commerce in any such article or class thereof to mark the article exposed or intended for sale with the sale price or to exhibit at some easily accessible place on the premises the price lists of articles held for sale and also to similarly exhibit on the first day of every month a statement of the total quantities of such articles in stock.
- g) Collecting any information or statistics with a view to regulating or prohibiting any of the aforesaid matters, and
- h) Any incidental to any of the aforesaid matters including the grant of issue of licences, permits or other documents and the charging fees therefore.

C. Creative Provisions

Creative provisions are positive in nature and involve co-operation between the Central Government, industry, labour and consumers of good produced by scheduled industries. Following are the specific creative measures.

Constituting Development Councils

The Central Government May by notified order establish in respect of any scheduled industry or group of scheduled industries, a Development Council which shall consist of members who in the opinion of the Central Government are:

- a) Persons capable of representing the interests of the owners of industrial undertaking in the scheduled industry or group of scheduled industries.
- b) Persons having special knowledge of matters relating to the technical or other aspects of the scheduled industry or group of scheduled industries.
- c) Persons capable of representing the interests of persons employed in the industrial undertakings in the scheduled industry or group of scheduled industries.
- d) Persons not belonging to any of the aforesaid categories who are capable of representing the interests of consumers of goods manufactured or produced by the scheduled industry or group of scheduled industries.

Functions of the Council

In particular, the Development Council shall perform the following function as laid down in the Second Schedule of the Act.

1. Recommending targets of production, coordinating production programmes and reviewing progress from time to time.
2. Suggesting norms of efficiency with a view to eliminating

waste, obtaining maximum production, improving quality and reducing costs.

3. Recommending measures for securing the fuller utilisation of the installed capacity and for improving the working of the industry, particularly of the less efficient units.
4. Promoting arrangements for better marketing and helping in the devising of a system of distribution and sale of the produce of the industry which would be satisfactory to the consumers.
5. Promotion standardisation of products.
6. Assisting in the distribution of controlled materials and promoting arrangements for obtaining materials for the industry.
7. Promoting or undertaking inquiry as to materials and equipment and as to methods of production, management and labour utilisation, including the discovery and development of new materials, equipment and methods of improvement in those already in use, the assessment of the advantages of different alternatives and the conduct of experimental establishments and of tests on a commercial scale.
8. Promoting the training of persons engaged or proposing engagement in the industry and their education in technical or artistic subjects relevant thereto.
9. Promoting the retraining in alternative occupations or personnel engaged in or retrenched from the industry.

10. Promoting or undertaking scientific and industrial research, research into matters affecting industrial psychology and research into the matters relating to production and to the consumption or use of goods and services supplied by the industry.
11. Promoting improvements and standardisation of accounting and costing methods and practice.
12. Promoting or undertaking the collection and formulation of statistics.
13. Investigating possibilities of decentralising stages and processes of production with a view to encouraging the growth of allied, small-scale and cottage industries.
14. Promoting the adoption of measures for increasing the productivity of labour, including measures for securing safer and better working condition and the provisions and improvement of amenities and incentives for workers.
15. Advising on any matters relating to the industry (other than remuneration and condition of employment) a to which the Central Government may request the Development Council to advise and under take inquire for the purpose of enabling the Development Council to advise, and
16. Undertaking arrangements for making available to the industry information obtained and for advising on matters with which the Development Councils are concerned in the exercise of any of their functions.

Levy and Collection of Cess

Section 9 of the Act provides that the Central Government may, by a notified order, levy and collect a cess for the purposes of this Act on all goods manufactured or produced in any scheduled industry as may be specified in this behalf by the central Government, a duty of excise at such rate as may be notified by the Central Government and different rates may be specified for different classes of goods, provided that no such rate shall in any case exceed two percent of the value of the goods. The cess may be recovered in the same manner as an arrear of land revenue.

The Central Government may, after collecting the proceeds of the cess, hand over the same to the Development Council which shall utilise the said proceeds for the following purposes.

- a) To promote scientific and industrial research with reference to the scheduled industry or group of scheduled industries in respect of which the Development Council is established.
- b) To promote improvements in design and quality with reference to the products of such industry or group of industries.
- c) To provide for the training of the technicians and labour in such industry or group of industries.
- d) To meet such expenses as may be necessary in the exercise of its functions and its administrative expenses.

Central Advisory Council

Section 5 of the Act provides for the establishment, constitu-

tion and the functions of the Central Advisory Council. It is stated that for the purposes of advising the Central Government on matters concerning the development and regulating of scheduled industries, the Central Advisory Council may be established by the Central Government by a notified order.

The Central Advisory Council shall be composed of a Chairman and such other members not exceeding 13 members as may be appointed by the central Government from among the persons who are in the opinion of the Central Government capable of representing the interests of the owners of industrial undertaking covered by scheduled industries, persons employed in industrial undertakings in scheduled industries, consumers of goods manufactured or produced by scheduled industries and such other class of persons including primary producers as in the opinion of the Central Government ought to be represented on the Advisory Council.

It is made obligatory for the Central Government to consult the Central Advisory Council in regard to the making of any rules other than the first rules to be framed by the Central Government. The Central Government may consult the Central Advisory Council in regard to any other matter connected with the administration of this Act in respect of which the Central Government may consider it fit to obtain the advice of the Central Advisory Council.

GOVERNMENT POLICIES FOR SMALL SCALE INDUSTRIES

* Introduction * Objectives * Tracing Small Scale Industry

Policy Since Independence. * Industrial Policy Resolution 1948. * Industrial Policy Resolution 1956 * Industrial Policy, 1977 * Industrial Policy Resolution 1980 * 1991 Policy Measure * Other Important Aspects of Government Policy * Tiny Sector * handloom Sector, * Village Industries * Rural Industries * Khadi and Village Industries * Industrial Estates * Auxiliary Industries.

Introduction

Policies constitute the framework or guidelines for appropriate decisions at varied levels. They generally consist of statements that affect the working of a sector of the economy. The working of small scale industries, too, is moulded by a number of policies which are the base for effective plan development.

The living standards of the people in the world vary considerably. Generally speaking, industrialised countries are known as developed countries in which industrial development is based on modern technology and research. The countries in which agriculture predominates are referred to as under-developed/developing countries. Under-developed countries are those where even agriculture is quite traditional. Developing countries have accepted mechanisation as a way of life all along and have concentrated on developing large industries.

For a developing country like India, the growth of small scale industries is of great significance. Apart from increased production the growth of small-scale industries helps to serve as an important

milestone in the country's march towards industrial democracy. This movement has to be fostered by all-round efforts, so that a new class of talented entrepreneurs, endowed with initiative and enterprise, come to the fore-front, in this country.

Objectives

The basic objectives of these industries are to create immediate and permanent employment on a large scale at a relatively small cost to meet a substantial part of the increased demand for consumer goods, and simple producer's goods, to facilitate the mobilisation of resources of capital and skill, which might otherwise remain inadequately utilised, and to bring about an integration of the development of these industries with the rural economy on the one hand and large scale industry on the other. Further, these industries are said to offer a method of ensuring a more equitable distribution of the national income and of avoiding some of the problems that unplanned urbanisation tends to create.

Basically, small industries are important for national development programmes because they can make a definite contribution to the realisation of the central purpose of such a problem i.e., to bring about an efficient utilisation of natural, human and capital resources of the country and for the achievement of pre-determined ends.

Tracing the Small Industrial Policy Since Independence

The need for the development of small scale, village and cottage industries has been the objective of the Government since independence.

Small Scale Industries: The main thrust of the Industrial Policy, 1977 was on an effective promotion of cottage and small industries widely dispersed in rural areas and small towns. It is the policy of the Government that whatever can be reproduced by small and cottage industries must only be so produced. For this purpose, the list of industries which would be exclusively reserved for the small scale sector had been significantly expanded and included more than five hundred and four items against about one hundred and eight items, reserved for this sector in the past.

Tiny Sector

While the existing definition of small scale industries will remain within the small scale sector itself, special attention will be given to units in the tiny sector, namely those with investment in machinery and equipment upto Rupees one lakh and situated in towns and villages with a population of less than fifty thousand according to the 1971, census. Schemes will be drawn up with a view, to making available margin money assistance to tiny units in the small scale sector as well as cottage and house-hold industries.

Arrangements for Provisions of Credit.

The financial assistance given to small and cottage credit under the rural industries programme will be extended to all the districts in the country within the next four years. IN order to provide effective financial support for the promotion of small village and cottage industries the Industrial Development Bank of India has taken steps to

set up a separate wing to deal exclusively with the credit requirements of this sector. It will co-ordinate, guide and monitor the entire range of credit facilities offered by other institutions for the small and the cottage industrial sector for which separate wings will be set up in these institutions, particularly in nationalised banks. Banks will also be expected to earmark a specific proportion of their total advances for the promotion of small, village and cottage industries. It was the policy of the Government to see to it that no worthwhile scheme of small or village industry is given up for want of credit.

Arrangements for Marketing.

The marketing of the production of the small scale and the cottage industries, with its concomitants of product standardisation, quality control, market surveys, etc, would receive special attention. The Government would provide maximum support for these activities on a priority basis. It would encourage the purchase of the products of the small-scale by Government Departments and Public sector undertakings with a view to supporting the marketing of these products.

Promotion of Khadi and Village Industries. The Khadi and Village Industries Commission presently has twenty two village Industries within its purview, but the promotional work in this area has been haphazard and the progress has been slow. It will henceforth, have to work out detailed plans for the development of these village industries by adopting modern management techniques. In this con-

text, special programmes would be drawn up to increase the share of village industries in the total production of footwear and soaps in the country. The list of items currently under the purview of the Commission will be expanded and the organisational structure of the Commission will be revamped to make it more effective.

The Khadi and Village Industries Act, has been amended to permit the implementation of a large scale programme for the manufacture of 'Nai Khadi'. The Government would provide maximum financial and marketing support needed for the promotion of the khadi programme.

Along with khadi, the clothing need of the masses would be progressively met by the development of the handloom sector, which provides employment to a large number of people. To effect this, Government will not permit any expansion in the weaving capacity in the organised mill and power loom sectors. It will give priority to handloom sector in the allocation of yarn spun in the organised sector. Further, in order to provide a market for handloom products, it would be ensured that the organised mill sector does not provide unfair competition to the handloom sector. The Government will enforce the existing reservation of certain items of textiles for the handloom sector and further expand it to other items.

Appropriate Technology: It will be an integral part of Government policy to ensure that the development and application of technology, appropriate to the country's socio-economic conditions receives adequate attention. Special arrangements will be made to ensure an

effective and co-ordinated approach for the development and widespread application of suitable small and simple machines and devices for improving the productivity of village industries. It will further, be the Government's endeavour to fully integrate such appropriate techniques of production with the broader programme of all round rural development.

Role of Large Scale Industries:

The role of large scale industry will be essentially related to the programme for meeting the basic minimum needs of the population by effecting a wider dispersal of small scale and village industries and strengthening of the agricultural sector. These will be.

- a) Basic industries, which are essential for providing infrastructure facilities as well as for the development of small and village industries, such as steel, non-ferrous metals, cement and refineries.
- b) Capital goods industries required for meeting the machinery requirements of basic industries and small scale industries.
- c) High technology industries requiring large scale production and which are related to agriculture and small scale industrial development such as fertilisers, pesticides and petrochemicals, and
- d) Other industries which are outside the list of items reserved for the development of the economy like, machine tools, or-

ganic and inorganic chemicals.

Indigenous and Foreign Technology

The Government's policy is that the future development of industries in India must as far as possible, be based on indigenous industries. Full scope will be given to the development of indigenous technology. Which would subserve the objective of efficient production of increasing quantities of the goods, which society urgently needs. The Government also recognises the necessity of continued inflow of technology in sophisticated and high priority areas, where Indian skills and technology are not adequately developed. In such areas. Government's preference would be for outright purchase of the base available technology and then adopting it to the country's needs.

Foreign Investment

The provision of the Foreign Exchange Regulation Act, Will be strictly enforced as far as the existing foreign companies are concerned. After the dilution of equity, companies with direct non-resident investment not exceeding forty percent will be treated on par with Indian Companies, except in cases, specifically notified, and their future expansion will be guided by the same principles as those applicable to Indian Companies. Foreign investment and acquisition of foreign technology as necessary for India's industrial development will be allowed only on such terms as determined by the Government of India, to be in the national interest. In areas, in which foreign

technological know-how is not needed, existing collaborations will not be renewed. The Government will issue a revised illustrative list of industries for which no foreign collaboration, financial or technical, is considered necessary if indigenous technology has fully developed in this field. For all approved foreign investments, there will be complete freedom for remittance of profits, royalties, dividends as well as remittance of capital, subject to rules and regulations. While, as a rule, the majority interest in ownership and effective control will be in Indian hands, the Government will make exceptions in highly export oriented cases. It may even consider, permitting a fully owned foreign company to operate in India.

Indian Joint Ventures Abroad: The Government's policy is that at the present stage of industrial development of the country the contribution of Indian entrepreneur to joint ventures abroad will be mainly in the form of machinery and equipment, structural, technical know-how and management expertise. If such investment is found necessary, the Government will be willing to consider such investment up to a maximum limit to be prescribed for this purpose.

Location of Industries: NO licenses will be issued to new industrial units within certain limits of large metropolitan cities having a population of more than one million and urban areas with a population with more than five lakhs as per the 1971 census. Further the State Governments and financial institutions will be requested to deny support to such new industries in these areas which do not require an industrial licence. The Government of India, would also consider providing assistance to large existing industries which want to shift

from congested metropolitan cities to approved locations in backward areas.

Industrial Policy Resolution, 1980

The Industrial Policy statement made, on 23 rd July, 1980 primarily seeks to harmonise the growth in the small scale sector with that in the large and medium sectors. The emphasis in the new policy is on fostering the complementarity between the small and large sectors so that the dichotomies, (which are more apparent than real) between the two sectors do not distort the economic pattern. In the words of the latest policy statement. "It will be Government's endeavour to reverse the trends of the last three years towards creating artificial divisions between the large and the small industry under the misconception that these interests are essentially conflicting.

The broad socio-economic objectives of the new policy have been set out as follows.

- i) Optimum utilisation of installed capacity
- ii) Maximising production and achieving higher productivity
- iii) Higher employment generation
- iv) Correction of regional imbalances through a preferential development of industrially backward areas
- v) Strengthening of the agricultural base by according a preferential treatment to agro based industries and promoting optimum inter-sectoral relationship.

vi) Faster Promotion of export oriented and import substitution industries.

vii) Promoting economic federalism with an equitable spread of investment and the dispersal of returns amongst widely spread small but growing units in rural as well as urban areas.

viii) Consumer protection against high prices and bad quality.

An important element of the new policy is the raising of the investment limits of the tiny and small scale sectors. These limits have been redefined in terms of investment in plant and machinery and have been fixed at Rupees two lakhs for tiny sector instead of Rupees one lakh, Rupees two lakhs for the small scale sector instead of Rupees ten lakhs and Rupees twenty five lakhs instead of Rupees fifteen lakhs for ancillaries. This step is essentially a pragmatic one and takes into account the significant price rise that has occurred in the last five years following the fixation of the investment limits for the small scale sector.

However, this decision would bring into the fold of the small scale sector a number of technology oriented units whose growth will have to be backed by a suitable system of incentives. The new industrial policy spells out some of these incentives which are proposed to be provided so that the small scale sector may grow in a significant measure and contribute to the national economy.

Financial Support to Small Units

One of the major constraints on the growth of the decentralised sector has been the difficulty of finance which has been experienced particularly by industrial entrepreneurs in small, cottage and rural sectors. Although there is an adequate network of institutional finance, it is nevertheless essential to co-ordinate the flow of capital both short term and long term. The Government should evolve a system of co-ordination to ensure the flow of credit to the growing units in the decentralised sector at the right time and on appropriate terms. It should strengthen the existent arrangements and make such changes as may be necessary to facilitate the availability of credit to the growing units in the small scale sector.

Buffer Stock for Critical Inputs

In order to assist in the growth of small scale industries, it has been proposed to introduce a scheme for the building up of buffer stocks of essential materials which are often difficult to obtain. For this purpose the existing set up of Small Industries Development Corporation's in the States and the National Small Industries Corporation (NSIC) at the centre will also be utilised. The special needs of the states which rely heavily on a few essential raw materials will receive priority.

Marketing Support and Reservation Items for Small Industries

Policies related to marketing support of the decentralised sectors and the reservation of items for small scale industries shall continue

to be in force, in the interests and growth of small industries.

Village Industries

Government is determined to promote such a form of industrialisation in the country as would generate economic viability in the villages. The promotion suitable to industries in rural areas will be accelerated to generate higher employment and higher per capita income for the villagers without disturbing the ecological balance. Handloom, handicrafts, khadi and other village industries will receive greater attention to achieve a faster rate of growth in the villages.

District Industries Centres

The Government has reviewed the scheme of District Industries Centres, which has not produced benefits commensurate with the expenditure incurred on them. It therefore proposes to initiate more effective alternatives.

The policy Statement of 1980, makes it clear that the existing support programme for marketing as well as for the reservation of items in the small scale sector will continue. These form an important underpinning of the small industry development programme. It is therefore proposed, that the existing policies will continue to operate to strengthen the small scale sector.

The basic thrust of the new policy is to ensure a continuous growth of other sectors. In this context, automatic growth for large number of industries in the medium and large sector has been ensured so that they can grow without hindrance.

A special emphasis has been laid on the establishment of "Nucleus plants" in backward districts around which a programme of ancillarisation, would be developed. To quote from the statement.

"The proposed nucleus plants in industrially backward districts would generate a network of small-scale units, on the existing network of small scale units in an area which would acquire a faster growth by the coming-up of a nucleus plant in the area. In between, the nucleus, large plants and the satellite ancillaries, the Government would permit a system of linkages for an integrated industrial developments.

1991, Policy Measure

Over the last few decades small enterprises emerged as leaders in industrial sector. They also played a more significant role in creating balances for economic and social development in the country. In recognition of their significance and stature, the new government announced Policy Measure on August 6th 1991 for promoting and strengthening of small, tiny and village enterprises.

Objectives

- 1) To impart more vitality and growth impetus to the small scale sector
- 2) To decentralise and delicense the sector.
- 3) To deregulate and debureaucratise the sector
- 4) To review all statutes regulations and procedures and effect suitable modifications where necessary.

- 5) To promote small enterprises especially industries in tiny sector.
- 6) To motivate small and sound entrepreneurs to set up new green enterprises in the country.
- 7) To involve traditional and reputed voluntary organisations in the intensive development of KVI through area approach.
- 8) To maintain sustained growth in productivity and attain competitiveness in the market economy, especially in the international markets.
- 9) To industrialise backward areas of the country.
- 10) Accelerate the process of development of modern small enterprises, tiny enterprises and village industries through appropriate incentives, institutional support and infrastructure investments.

Salient features.

- 1) Legislation to limit financial liability of new and non-active partners/entrepreneurs to the capital invested.
- 2) Hike in investment limit for tiny sector up from Rupees two lakhs to rupees five lakhs.
- 3) Service sector to be recognised as tiny sector.
- 4) Support from National Equity Fund for projects upto Rupees ten lakhs.
- 5) Single window loans to cover projects upto Rupees twenty lakhs. Banks also to be involved.
- 6) Relaxation of certain provisions of labour laws.

- 7) Sub-contracting Exchanges to be set up by industry association.
- 8) Easier access to institutional finance.
- 9) Factoring services through SIDBI to overcome the problem of delayed payments. Also, legislation to ensure payment of bills.
- 10) Women enterprises redefined.
- 11) Marketing of mass consumption items by National Small Industries Corporation, under common brand name.
- 12) Composite loans under the single window scheme also to be given by banks.
- 13) Tiny sector to be accorded priority in government purchase programme.
- 14) Priority to SSI's and tiny units in allocation of indigenous raw materials.
- 15) Promise to deregulate and debureaucratise small and tiny sector.
- 16) PSUs and NSIC to help market products through consortia approach, both domestically and internationally.
- 17) Janata Cloth Scheme to be replaced by a new scheme which will provide funds for loans and modernisations.
- 18) Compulsory quality control for products that pose risk to health and life.
- 19) Legislation to ensure payment of small scale industries bills.
- 20) A special monetary agency to be set up for the small scale

sector's credit needs.

- 21) A new scheme of integrated infrastructural development to be implemented.
- 22) A technology development cell to be set up.
- 23) Incentives and services package to be delivered at the district level.
- 24) An expert development centre to be set up.
- 25) Khadi and Village Industries Commission (KVIC) and boards to be expanded.
- 26) Investment limit of ancillary units and export-oriented units raised to seventy five lakhs.
- 27) Traditional village industries would be given greater thrust.

OTHER IMPORTANT ASPECTS OF GOVERNMENT POLICIES

Tiny Sector

The Policy Statement gives a new thrust for the development of Tiny enterprises which accounts for nearly ninety percent of all small scale units. The investment ceiling has been raised from Rupees two lakhs to Rupees five lakhs. A significant feature of the policy is the due recognition. In order to strengthen the tiny sector it has been decided to recognise all industry related service and business enterprises irrespective of their location, as small scale industries. Their investment ceiling would correspond to those of tiny enterprises.

While the small scale sector (other than Tiny enterprises) would

be mainly entitled to one time benefits (like preference in land allocation/ power connection access to facilities for skills, technology upgradation) the Tiny enterprises would also be eligible for additional support on a continuing basis, including easier access to institutional finance, priority in the Government Purchase Programme and relaxation from certain provisions of labour laws.

Handloom Sector

Schemes for the handloom sector will be redesigned keeping in mind the local and regional needs. Substantial funds will be provided for modernisation of looms, training, provision of better designs, provision of better dyes and chemicals and marketing assistance. Spinning capacity in the cooperative sector will be increased, National Co-operative Development Corporation, Will provide more assistance for this in the form of seed money, both for cotton growers, spinning mills and weaver's spinning mills.

The Janata Cloth Scheme which sustains weavers often on a minimum level of livelihood will be phased out by the terminal year of the Eighth Plan and replaced by the "omnibus project package scheme" under which substantial funds will be provided for modernisation of looms, training, provision for better designs, provision of better dyes and chemicals and marketing assistance.

The role of the National Handloom Development Centres (NHDC's) is also being enhanced. It would now be a nodal agency for increasing supply of hand yarn, dyes and chemicals.

For the handicraft sector, "craft development centres" are proposed to be set up which would ensure are materials, design and technical guidance, market support, training and procuring of related inputs in an integrated and area based manner. Measures are also proposed to be initiated to increase exports from this sector through new marketing channels like trading companies, departmental stores, etc.

Village Industries

Intensive development of KVI through area approach with tie up with DRDA, TRYSEM and ongoing developmental programmes relating to weaker sections like scheduled castes, scheduled tribes and women would be extended throughout the country. The traditional village industries would be given greater thrust.

Involvement of traditional and reputed voluntary organisations will be encouraged for this purpose. The new policy's success depends substantially on the quality of the service provided by bodies like Small Scale Industries Development Organisation, Prototype Development Centres, NSIC, etc., whose services in the past have not inspired much success.

Rural Industries

Rural industry embraces different kinds of village and small industries. The cottage industries are an important component of rural industries. By the term "rural industry" is meant industry appropriate for the rural areas as demarcated by the census records. The concept here has a special demographic undertone. The rural industry serves the re-

quirements of rural people as well as other markets. By and large, the financial needs of rural industry are small. More importantly, they function in the absence of infratrural facilities and are environmentally friendly.

Type of Rural Industry

By and large rural industries are interlinked with agricultural activities, rural development and service sector. They may also be grouped into small scale industry, tiny industry and rural artisans (self-employed). The scope for process industry is vast and unexplored. The need of the hour is the proper organisation of rural industries and integrate them into the rural ethos and development.

Importance of Rural Industrialisation:

Rural industrialisation is important not only as a means of generating employment opportunities in the rural areas with low capital cost and raising the real income of the people, but because it contributes to the development of agriculture and urban industries. Without rural industrialisation, it would be considerably more difficult to solve the problem of agricultural unemployment and widespread under employment. Rural industrialisation promotes rural industry. The development of rural industries, increases the level of income in rural areas and tends to break down the old self-sufficiency of the family and to lessen its cohesiveness, creating opportunities for youth, women and the able bodied as well in changing the pattern of leisure and work. Rural industrialisation should be looked upon not merely as a way of containing the rural workers and stopping them from migrat-

ing to urban areas by providing them some kind of remunerative employment in the villages, but as a dynamic element in the process of raising the productivity and income levels of the workers in rural areas.

The main characteristics of these industries are to develop local initiative, co-operation and spirit of self reliance in the economy and at the same time help in utilisation of the available manpower for processing locally available raw materials by adopting simple techniques.

These are capable of offering employment opportunities at the place of residence to a large section of population. The village industries are an antidote to the widespread problems of disguised unemployment or underemployment.

These decentralised industries require less gestation period on the one hand and produce goods of common necessities on the other.

These industries have the capacity to correct regional imbalances by initiating industrial activities on dispersed basis in the most neglected, back ward, inaccessible areas when perhaps large scale sector is unable to penetrate.

Being small, these activities can ensure maximum participation of workers in management thus, ensuing a feeling of involvement which is so uncommon with the large scale sector.

These industries possess an additional advantage wherein the maximum participation of women folk can be ensured.

Rural industrialisation has taken roots in the rural economy in

India. This is so because simple forms of manufacture, typical of consumer goods industries and varied service industries, are everywhere developed before the more complex process involved in the production of capital goods, and because the size of the home market at the time of industrialisation, prohibits the establishment of optimum sized plants in the production of certain capital goods.

Khadi and Village Industries

The development of village and khadi industries provides opportunities for work, albeit part time work, in certain cases and thereby helps to mitigate the severity of rural unemployment and underemployment. With this end in view, the Khadi and Village Industries Commission (KVIC) was established in April 1957, under the Khadi and Village Commission Act, 1956.

Under the guidance of Mahatma Gandhi, provisional activities of khadi were started in 1922, when they were symbolic of the "Fight for Freedom". The khadi programme was thus closely linked with the struggle for freedom. The All-India Congress Committee, then known as the All-India Spinner's Association (AISA) was established in 1952, to organise hand-spinning and hand-weaving. This was followed by the establishment of another organisation in 1935, called the All India Village Industries Association (AIVA), to look after other village Industries such as hand pounding of paddy, ghana oil, palm gur, bee keeping, hand made paper, etc. The establishment of Khadi Commission was the culmination of the efforts to organise cottage/village industries during the freedom movement. In 1951, the Sarva Seva Sangha

took over the work of AISA and AIVA, as a part of an integrated plan for rural industrialisation.

The Government of India, evolved a general policy frame-work for the development of these industries. IN the First Plan, these industries were treated as an integral part of agriculture, and the emphasis was on the local consumption. In the Second Plan on the advice of the Village and Small Scale Industries Committee (Karve) 1955, was in consonance with the Industrial Policy Resolution of the whole plan for the country's industrialisation. The Third Plan retained the emphasis on these programmes while, highlighting the need for an integrated approach. In the successive plans, the emphasis and polity were shifted from one of protection of such industries to positive forms of assistance such as improving skills, supplying technical guidance, better equipment and adequate credit with a view to increasing productivity and reducing cost.

The government is committed to the encouragement of the production of textiles and textile products in the khadi sector. Considering its large employment potentia, it should be the endeavour of the government to make products of these sectors, more competitive and of better quality.

The infrastructure for the distribution of controlled cloth, particularly in rural areas, will be strengthened and streamlined. State governments will be encouraged to open more rural outlets and exercise stricter control over distribution.

Functions of KVIC: The functions of KVIC, also comprise building up a reserve of raw materials and implements for supply to producers, creation of common service of facilities for processing,

marketing and training. Other functions are.

- 1) To promote the sale and marketing of khadi products of village industries or handicrafts. The KVIC may forge time with established marketing agencies wherever necessary and feasible.
- 2) The KVIC is also charged with the responsibility of encouraging and promoting research in the production techniques employed in the khadi and village industries sector and providing facilities for the study of the problems relating to it including the use of non-conventional energy and electric power with a view to increasing productivity, eliminating drudgery and otherwise enhancing their competitive capacity and to arrange for dissemination of salient results obtained from such research.
- 3) Further, the KVIC is entrusted with the task of providing financial assistance to institutions or persons engaged in the development and operation of khadi and village industries and guiding them through supply of design, prototypes and other technical information.
- 4) In implementing KVI activities the KVIC may take such steps to ensure genuineness of the products and to set up standards of quality and ensure that the products of khadi and village industries do conform to the standards including issue of certificates or letters of recognition, to the concerned.

- 5) The KVIC may also undertake directly or through other agencies studies concerning the problems of khadi or village industries besides experiments or pilot projects for the development of khadi and village industries.
- 6) The KVIC is authorised to establish and maintain separate organisation for the purpose of carrying out any or all of the above matters incidental to its activities.

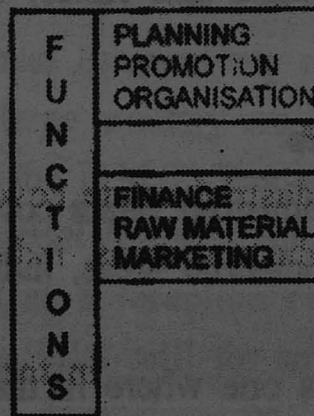


Fig. 2.4 Functions of KVIC

Industrial Estates

Industrial estates and ancillary industries were started in India with great hopes in their efficacy as tools of industrial dispersal, rural industrialisation and to sustain growth of the small scale industries. In India, industrial estates and ancillary industries have been utilised as an effective tool for the promotion and growth of small scale industries. They have also been used to decentralise industrial activity to rural and backward areas.

According to P.C. Alexander an Industrial Estate is "a group of factories, constructed on an economic scale in suitable sites with facilities of water, transport, electricity, steam, bank, post office, canteen, watch and ward and first-aid, and provided with special arrangements for technical guidance and common service facilities".

The United Nations has defined an Industrial Estate as "a planned clustering of enterprises, offering standard factory buildings, erected in advance of demand and variety of services and facilities to the occupants".

Type of Industrial Estate

The service term, industrial estate covers all the four variants of the concept namely, industrial areas, industrial estates, industrial townships and galas.

An industrial area is one where in the infrastructure facilities and services are provided but factory accommodation is constructed by entrepreneurs. In an industrial estate, both infrastructural facilities and factory sheds having accommodation and other civic amenities associated with a town are also provided.

In galas, space is provided in a big building to set up small scale industries along with infrastructural facilities.

On the basis of functions, industrial estates are classified into, a) Conventional (general) type (b) special type.

General type industrial estates provide accommodation to a wide variety and range of industrial concerns, while, special type estates

attempt the establishment of industrial units, which are vertically or horizontally dependent. In India, general type estates are very popular.

On the basis of the origination set up, industrial estates are classified into.

a) Government (b) Private c) Co-operative and d) Municipal estates.

There are a number of other variants of industrial estates such as.

a) *Ancillary Industrial Estate*: Only small industries which are ancillary to a particular large industry are housed in this estate, just like the one attached to the H.M.T. Bangalore.

b) *Functional Industrial Estate*: This is a small and fully serviced unit which serves as a reception centre for displaced small firms. It also serves as a 'Pilot-cell' for small firms going into production and is a base for expansion into larger factories.

c) *The Workshop Bay*: This is designed for very small firms and is usually meant for artisans who do mainly repair works.

d) *The service Industrial Bay*: This is usually located in the shopping centres to provide space for repair shops and enterprises such as job-printing.

Objectives of Industrial Estates

The objectives underlying the establishment of industrial estates in India are as follows.

i) to encourage the growth of small-scale industries.

- ii) to shift small scale industries from congested areas to estate premises with a view to increasing their productivity.
- iii) to achieve decentralised development in small towns and large villages.
- iv) to encourage growth of ancillary industries in the townships, surrounding major industrial under taking, both in public and private sector, and
- v) to faster the development of industry as well as entrepreneurship by providing economies and incentives.

Lessons of Experience

According to Development Commissioner of Small-Scale Industries, the following lessons of experience could be drawn for future.

- 1) Industrial estates have to be properly co-ordinated with the broader development programme. They have to be not only an integral part of the industry development programme but also of the overall economic development programme of the area/region.
- 2) Industrial estates should be planned with a view to developing them into focal points of healthier industrial growth in an area rather than as a cluster of merely inward looking group of production units. They are to be so designed and managed that they may later be in a position to provide necessary common service facilities, technical advice, guidance etc, to other industrial units in the area.
- 3) Homogeneity (rather than heterogeneity) is to be guiding

criterion while selecting industrial units. This would lead to better planning and utilisation of common facilities, inter firm co-opation and inter-linked development.

- 4) While planning an industrial estate, due consideration is to be given to "secondary growth" effect in order to regulate any haphazard growth around the estates.
- 5) Location of an industrial estate is to be decided only on techno-economic considerations. A techno-economic feasibility study should always precede the setting up of an estate.
- 6) While planning industrial estates in an area uniform pattern need not be followed. The organisational structure in a particular area/region may be adjusted taking into consideration factors such as special requirement of an area, economic developments, availability of skills, talents and enterprise, level of development of the region etc.
- 7) Instead of building sheds in advance of demand sheds may be build on the expressed demand as revealed at the time of conducting techno-economic or feasibility studies.
- 8) Elaborate and costlier construction has to be avoided and instead, functional types of sheds at cheaper rates may be provided.
- 9) When private initiative is ready, or the success of industrial estates has been demonstrated by one or more examples, government may confine it role to prescribing minimum factory standards etc. and increasingly associate the entrepreneurs in the work of construction and maintenance of

buildings

- 10) To keep construction costs to the minimum, adequate attention should be paid to reduce the cost by improving design efficiency, increasing the size coverage and reducing to the minimum the area allotted for non-factory purposes. The scope for reducing expenditure and non-development and administrative activities in the estates may also be explored and the consequent implications of cost of construction on, rent may be kept in view.
- 11) In back ward and rural areas greater efforts would have to be made to stimulate local entrepreneurship. The industrial estates in such areas have to play promotional role and act as pace-setters in the process of industrial development besides guiding the entrepreneurs in selecting the right lines of manufacture, it may also be necessary to offer additional incentives for locating industrial units. These incentives may be in the shape of concessional credit, rebates in various taxes, preferential allotment of scarce raw material etc. The industrial estates in back ward areas have also to be nursed over longer periods and provided with adequate inducements to counter balance the inherent disadvantages from which they suffer. The concessions could be given preferably as a 'Package deal' on a tapering basis.
12. The selection of products to be manufactured in the industrial estates should be in accordance with other develop-

ment programme, viz., mechanisation of agriculture, utilisation of agriculture produce, electrification items of mass consumption, etc.

13. While general purpose industrial estates are very useful for backward and rural areas in urban areas functional or special types of industrial estates may be preferred in view of the emphasis on modernisation, ancillary development etc.

An industrial estate is a method of organising, housing and servicing industry for an orderly development. It is considered as a multipurpose tool supposed to take care of provision of suitable factory premises utilities, facilities and services, economy in the investment on social overheads and the increased scope for inter-servicing and inter-trading development of complementarily in production and creating of the spirit of co-operation, decentralisation of industry for development of backward areas, more industrialisation, achieving a specific locational pattern, town planning, etc. In short, it accelerates the integrated development of small scale industries in the country.

Ancillary Industries

A balanced industrial development consistent with social justice calls for diffused ownership and control and also decentralised growth of industries. This is possible only if new entrepreneurship is developed. The process ancillarisation is one of the most handy methods of encouraging new entrepreneurs to set up small scale units. This is so because, the running of ancillary industry does not give rise to complex problem which the uninitiated new entrepreneur will have to face if he is

to run an independent manufacturing unit. Also, ancillarisation makes it possible for him to establish a coherent relationship with small and large units. It is these circumstance that ancillaries can provide a strong and widespread base for industrial development.

A major problem faced by ancillary units is their vulnerability to variations in demand. When the large scale manufacturer producing an end product, face slackness in demand the ancillary unit supplying the components is hit hard and may have to remain practically idle until the demand for the end product revives. Since the production apparatus in the ancillary units is highly specialised and tailored to meet the requirements of a particular assembly it is not possible to switch over to any other item without incurring losses on account of machinery installed.

An ancillary unit, therefore, is a "Captive unit" with no alternative outlet. Its difficulties are often aggravated by delay in the payment of bills. During times of financial stringency, there is a tendency on the part of the parent firms to sequence the ancillary units by giving "themselves the credit through non-payment of bills. A survey of industries in Japan revealed that only eight percent of the firms received payment within sixty days and that the remaining ninety two percent received it after the lapse of sixty days to one hundred and fifty days. In this particular respect, therefore ancillary units are in more vulnerable position, than small scale industrial units. A small scale industrial unit producing consumer items or other products will be able to make quick adjustments in its production plan as well as product design in order to minimise the adverse impact of a fall in demand. It may consider diversifying its activity with marginal

addition to its machinery and/or equipment. It may even supply its products to other markets, if the traditional markets fail. But ancillary units are tied to the "apron strings" of one or two specific large scale units and often find it extremely difficult to make such adjustments. As a result they get adversely affected.

While ancillary units suffer from these disabilities, they are free from the usual worries about the marketing of their products. An ancillary unit produces for a pre-determined market because its production is effected against advance orders. It may be provided with scarce raw materials or even finance by the parent firm depending upon the type of relationship between the two and during periods of rising demand and plentiful orders, the ancillary unit can continue to operate, with hardly a problem.

In India, unlike other countries, the ancillaries sponsored by large units, suffer from a major handicap. They lean too heavily on the large units. This dependence may be unavoidable in the initial stage of development, but the ancillary should be able to stand on its own legs after a time, which would be possible only if the accent is placed on product improvement, cost reduction and the development of export outlets, especially when the ancillary product is able to meet the requirements of the replacement market abroad.

Factors affecting Ancillarisation:

Recently there has been growing trend towards ancillarisation due to the series of the rapid developments that have taken place in

the industrial structure in the country. The various factors affecting ancillarisation are.

- 1) The size of the operations of several industrial units has increased enormously, with the result that they are compelled to sub-contract some of the items of production to ancillaries. During the 1950's these industrial units were set up, so that the production of all the components against the stipulated targets might be met in term of the licences granted to them. In those days, there were few and ancillary units adequately equipped to produce the components according to specifications. But during 1960's a large number of small scale units, which were capable of producing a variety of items emerged with the result that large scale manufactures developed enough confidence in them to assign the production of specific items to these units.
- 2) It was more convenient for large scale manufacturers to get the ancillary units to produce certain items for them with the growing complexity of management, the large scale manufacturer can now concentrate on the problems of organisation, marketing, finance etc., rather than fritter away his energies on finding raw materials and framing production plans for the manufacture of the several minor items which go into the final assembly. For example, a bicycle manufacturer does not have to bother about buying and stocking of rubber used in the

production of pedals, he prefer to get this item supplied to him by an ancillary unit.

- 3) Large scale manufacturers can economise on transport costs, storage space, etc., by sub-contracting rather than by producing the same components themselves.
- 4) It is economic to have some items manufactured by ancillary units because the cost of these items is higher when they are fabricated by large scale manufacturers.
- 5) By sub-contracting, a large scale manufacturer is able to insulate himself against fluctuations in the prices of raw materials over a period of time by entering into contracts for the supply of these items. A more accurate assessment of the input cost as well as the returns on manufacture is possible if the components are available at fixed price.

All these facts underscore the point that the development of ancillaries and their growing popularity have been well supported by economic and management considerations.

QUESTIONS

1. Bring out the various economic reforms. Why were these reforms necessary ?
2. How far the new economic policy succeeded ? Failed ? Discuss.
3. What is Industrial Policy ? What are its objectives ?

4. Why is the Industrial Policy, 1956 hailed as the Economic Constitution of India ?
5. Comment on the 1991 policy.

FINANCIAL INSTITUTIONS AND CAPITAL BUDGETING

Introduction

Finance is considered to be the "life blood" of business, specially in the case of small scale industries, finance is the key factor / input for growth and their development. The development of the economy after independence, has been built by a network of specialised financial institutions with fairly big capital base to provide financial assistance to all types of industries. There are various financial institutions which deals with different types of financing.

Depending upon the nature of activity, the entrepreneurs require three types of finance :

1. **Short term** : Funds required for a period less than one year.

E.g. : Bank credit, trade credit, customer advance etc.

2. **Medium term** : Funds required for a period of one to five years.

E.g. : Loans from financial institutions, public deposits, ploughed back profits etc.

3. **Long term** : Funds required for a period exceeding five to seven years.

E.g. : Issue of shares, issue of debentures, loans from financial institutions, ploughed back profits.

Depending on the type of finance required the entrepreneur can approach the financial institutions.

Annexure I gives the details of the information sought by the financial institutions in "Application for Financial Assistance".

Annexure II gives the "Procedure and Review of Term Lending Financial Institutions".

Financial Institutions

The leading financial institutions in the country who aid in establishing and running of business including modernisation, rehabilitation are :

- 1) Industrial Credit and Investment Corporation of India (ICICI)
- 2) Industrial Development Bank of India (IDBI)
- 3) State Financial Corporation (SFC)
- 4) Industrial Finance Corporation of India (IFCI)
- 5) Commercial Banks
- 6) Other Institutions :
 - i) Unit Trust of India (UTI)
 - ii) General Insurance Corporation (GIC)
 - iii) Life Insurance Corporation (LIC)
 - iv) National Small Industries Corporation (NSIC)
 - v) Commodity Boards (CB)
 - vi) States Small Industries Corporation (SSIC)
 - vii) State Trading Corporation (STC)
 - viii) Exports House (EH)

Industrial Credit and Investment Corporation of India (ICICI)

Introduction

The 'CICI, was established on 5th January, 1955 with its headquarters in Bombay for the specific purpose of assisting the industrial enterprise within the private sector. The original idea of forming the Corporation sprang from conversation between the Government of India and the World Bank and certain American finances. The World Bank made effort to encourage the flow of foreign and capital to enterprise in the private sector. It designed to build up a financial infrastructure for a booming industrial growth. i.e., development corporation to assist the expansion and renovation of private industry.

Objectives or Goals

The basic objectives or goals are to assist in the creation, expansion, modernisation of enterprise in the private sector, to encourage and promote the participation of private capital (foreign and internal) in such enterprise and to encourage the private ownership of individual investment. It tries to fulfil these objectives, by the following methods.

- i) Providing long term loans, medium term loans and equity participation to the private sector.
- ii) Sponsoring and underwriting new shares and debentures.
- iii) Granting loan from other private investment sources.
- iv) Making funds available for reinvestment by recovering

Investment as rapidly as possible.

- v) Furnishing managerial technique and administrative advice to the enterprise.
- vi) Assisting the promotion, expansion and modernisation of industrial enterprise in private sector.

Functions

To achieve the objectives the Corporation performs the following functions.

- i) It grants loan repayable, over a period upto 15 years.
- ii) It makes arrangement for similar loans in foreign countries, for payment of imported capital equipments and technical services.
- iii) It guarantees rupee payment for credit.
- iv) It subscribes to equity preference share capital, directly and underwrites public issue of industrial securities.
- v) It franchises, technical and administrative assistance to industrial undertaking.

Financial Resource

The authorised capital of the Corporation is Rupees twenty five crores, divided in five lakh equity shares of Rupees one hundred each and twenty lakhs unclassified shares of Rupees one hundred each. At the end of July 1979, the paid - up capital of ICICI was Rupees twenty two crore. It had total borrowings of Rupees four hundred and fifty one crores, which comprises debentures and borrowings

from the Government of India.

Working of ICICI :

Since its inception, upto the end of March 1984, lending to the large scale enterprise in the private sector amounted to Rupees two thousand six hundred and twenty seven crores. The total amount disbursed during the period was Rupees one thousand nine hundred sixty six crore. The assistance was granted to two thousand three hundred and eleven enterprises.

Industrial Development Bank of India (IDBI)

Introduction

The IDBI was wholly owned subsidiary of Reserve Bank of India (RBI) established in July 1964, under the Industrial Development Bank of India, Act.

It was wholly owned subsidiary of the RBI upto Feb. 15th, 1976 but it was delinked from the RBI with effect from Feb. 16th, 1976 and made an autonomous corporation, fully owned by the Government of India.

The IDBI Act was amended, in October, 1994 imparting IDBI greater operational flexibility and allowing it access to capital market through public issue of equity shares subject to government holding at any level, not below fifty one percent.

Objectives or Goals : The IDBI Act, 1964 specifies the following objectives underlying the formation of the development bank as an apex institution in industrial finance.

- i) Co-ordinating the activities of other financial institution.
- ii) Supplementing the resources
- iii) Planning and promoting industries of key importance, for the industrial structures
- iv) Adopting and enforcing a system of priorities in promoting further industrial growth.

IDBI, therefore is accepted to give developmental orientation to financial structure and operation, so that countries ambitious industrial plan, can be implemented, and also enable the financial institutions, including the bankers to be liberal and progressive in providing term loan to industry.

Functions :

The following are the main function of IDBI :

- i) Direct assistance
- ii) Indirect assistance
- iii) Special assistance

i) Direct assistance

The IDBI grants direct assistance, by way of project loan, underwriting, and direct subscription to industrial securities, loan, technical refunds loans and equipment, and finance loans. It subscribes to purchase and underwrite the issue of stocks, share and bonds.

ii) Indirect assistance

The IDBI can assist industrial concern in an indirect manner, i.e., through other institution. First of all it can refinance term loans

to industrial concerns repayable within three to twenty five years given by IFCI, SFC and other financial institutions.

iii) Special assistance :

The IDBI Act, 1964 has provided for creation of special funds known as development assistance fund, and it can be used, to assist those industrial concerns which are not able to secure funds in the normal course because of low rate of return.

State Financial Corporation (SFC)

Introduction

The SFC Act was passed in 1951. It authorised state government, to provide financial help to medium, small scale industries. The SFC can give loans upto ten lakhs.

The Government of India after independence, felt the need for creating financial infrastructure at the state level, to assist the promotion and expansion of small scale and medium sized industries. SFC set up in 1978, was meant to cater to the need of the large sized industries.

Functions

SFC's are empowered to grant financial assistance in the following forms :

- i) Loans and advances to a subscription of debentures, of industrial concerns, repayable within twenty years.
- ii) Guaranteeing loan raised by industrial concern, repayable within

twenty years.

- iii) Underwriting the stocks, shares, debentures, subject to their being dispersed of in the market within seven years.
- iv) Guaranteeing deferred payments due from industrial concerns on their purchase of capital goods in India.

Objectives

The main objectives of SFC's are meant to finance small and medium scale industries recognising their need for regional development. It makes a significant contribution to the industrial advancement, of respective states. It grants loans mainly for the acquisition of fixed assets, like land, buildings and plant and machinery. They also provide loans for working capital margin in combination of loans for fixed assets.

Criticism

i) *Inadequate resources* : These corporations have been raising resources, through the issue of share and bonds, with reference facilities from the Industrial Development Bank of India and by borrowing from the Reserve Bank of India. As a matter of fact, these resources are not sufficient to meet the requirements of borrowers.

ii) *High rate of interest* : These corporations charge high rate of interest. Other expenses like registration fee also increase the total cost of borrowing.

iii) *Uncertain performance* : The benefit of the corporations have been uncertainly spread over the different states.

The more developed state, took advantage of the funds made available by these corporations.

Industrial Finance Corporation of India (IFCI)

The IFCI was the first special financial institution, established in 1948 with the main objective of financing loan and short term needs of industrial organisations in the country. The main aim of the Corporation, is to provide medium and long term credit, make finance readily available to industrial units where normal banking accommodation is not available. Following concerns which are involved in.

- i) The manufacture of goods ;
- ii) The presentation of goods ;
- iii) The processing of goods ;
- iv) The mining industry ;
- v) The shipping industry ;
- vi) The hotel industry ;
- vii) The generation of distribution of electricity.

also are eligible for recommendation from IFCI. It renders assistance to units in the private sector. It has accommodated certain public sector enterprises also.

Now IFCI is allied to Industrial Development Bank. The Board of Directors, are partly nominated and partly elected representing participating share - holders.

Functions :

- i) Generating loans, required by industrial concerns which are repayable over a period not exceeding twenty years and are floated in the public market.
- ii) Underwriting of the issue of stock, shares, debentures issued by the industrial concerns, but they must be disposed off within seven years.
- iii) Granting loans or advances to, or subscribing to debentures issued by the industrial concerns, but they must be disposed off within seven years.
- iv) Expenses generated in respect of deferred payments by importers, who are able to make such arrangement with foreign manufactures.
- v) Acting as the agent of the control, as for World Bank in respect of loaning.

Objectives / Advantages

1. *Fosters employment* : The various projects financed by IFCI provides employment to four lakh persons in organisationed sector and accounts for nearly twenty percent of the country's annual exports.

2. *Encouragement to new enterprises* : It helps in bringing on the industrial horizon, quite a number of new entrepreneurs and technicians. Corporation has been concerned about the organisations promoted by new entrepreneurs and technologists, thus helping to broaden the country's entrepreneurial base.

3. *Contraction of regional imbalances* : Another major contribu-

tion made by the Corporation, is the assistance for setting of industry in rural and backward areas to improve its conditions as well as reduce regional imbalances.

4. Diversification of industrial production : The assistance to the non-traditional industries has helped in the diversification of industrial production in the country. Concerns assisted by the Corporation now produce for the first time in the country several items which were being imported previously. A good number of these items have been taken up for manufacture with indigenous know-how.

Commercial Banks

Commercial banks are very important source of finance for the industry. The industrial sector is getting around fifty percent of the total banks credit, particularly since the major bank nationalisation of 1969, there has been a substantial expansion of the bank branch network and a substantial growth of the bank deposits and credits.

Functions

The commercial banks besides providing term credit and subscribing to shares and debentures, indirectly participate in term finance by subscribing to the shares and debentures. Some of the banks have merchant banking divisions also. Scheduled banks have been permitted to hold in their own investment portfolios shares and debentures of the private corporate sector, developing on them through their underwriting and merchant banking commitments. However, accord-

ing to RBI directives such investment should be normally limited to the extent of fifteen percent, of the incremental deposits, of the previous financial year.

Objectives :

In order to ensure proper coordination between commercial banks and state level financial institutions, banks were advised to take certain measures which entirely include joint or simultaneous project appraisal, in principle, commitment by banks at an early stage, to provide working capital finance and sanctions of working capital limits, atleast three months, before the units are due to commence production.

OTHER INSTITUTIONS

1. Unit Trust of India (UTI)

A public sector, investment institution was established in 1964, under the Unit Trust of India Act 1963.

The share capital of UTI was subscribed by the IDBI, LIC, SBI and its subsidiaries and other scheduled banks and financial institutions. Sale of units and other saving schemes are the main source of funds for the trust.

The main objective of UTI, is to mobilise the savings of the community and channel them into productive corporate investments, so as to provide for growth and diversification corporate investments, so as to provide for growth and diversification of the economy. It provides the facility to growing number of investors in small and

medium income group for an equity type of investment that is to indirectly participate in the ownership of shares and debenture of industrial concerns. For small investors the UTI offer advantages of:

- i) Considerably reduced risk, since funds are invested in a balanced and well distributed portfolio
- ii) The benefit of expert management
- iii) A Steady income
- iv) Liquidity

The UTI is registering appreciable growth in sales, number of unit holding accounts, investible resources, income and reserves, the UTI is a significant participant of Infrastructure Leasing and Financial Services. Credit Rating Information Services of India Ltd, Stock Holding Corporation of India Limited, and Canfin Homes Ltd, which are expected to play a vital role in the improvement and development of the money market, capital market and housing finance in India.

2. Life Insurance Corporation of India (LIC)

The Life Insurance Corporation of India was established in 1956, as a wholly owned corporation of Government of India in order to carry on business of life insurance and deploy the savings to the best advantage of the policy holder's and the community as a whole. Its fund's are deployed to assist the development of social overheads like housing, rural electrification, water supply and sewage schemes.

It also provides substantial assistance to the industrial sector. LIC

extends resource support to the term lending institution, by way of subscription of their bonds and thus contribute to industrial financing in an indirect manner.

3. General Insurance Corporation of India (GIC)

As a member of the Constitution of All India Financial Institutions, the GIC and its four subsidiaries (The United India Insurance Co. Ltd., Oriental Fire and General Insurance Co. Ltd. National Insurance Co. Ltd., and New India Assurances Co. Ltd.,) provide assistance to industries in the form of loans, underwriting and direct subscription to shares and debentures, placement of short term deposits with companies, etc.

GIC along with LIC and UTL, buys back debentures tendered by individual holders, back to companies for encashment after a stipulated period and thus provide liquidity to such long term financial assets.

4. National Small Industries Corporation (NSIC)

The National Small Industries Corporation (NSIC) is a Government of India undertaking which was set-up in 1955, with the objective of supplying machinery and equipment to small enterprises on a hire-purchase basis and assisting them in procuring government orders for various items of stores.

Functions of NSIC

- 1) To provide SSI with modern machines on hire-purchase basis.
- 2) To assist small enterprises to participate in the stores purchase programme of the Central government.

- 3) To develop SSI as ancillary units, to large scale industries.
- 4) To arrange for a marketing of the products of small industry by starting emporiums and sales depots and promoting their exports.
- 5) To distribute basic raw materials through their raw material depots.
- 6) To import and distribute components and parts to actual small scale users in specific industries.
- 7) To construct industrial estates, establish, and run prototype production-cum-training centres, with a view to giving impetus to developmental efforts and to supplement the activities of State, Small Industries Corporations (SSICs) and District Industrial Centres (DICs), the NSIC has opened its offices in some of the states in which the NSIC has been hitherto under-represented.

The NSIC has taken itself the challenging task of promoting and developing small industries, from scratch. It has created a proper climate and has infused confidence in the small entrepreneurs to prepare schemes for the manufacture of products or identify the balancing equipments for purpose of modernisation and/or diversification. NSIC supplies machineries and equipments, marketing inputs and technical support.

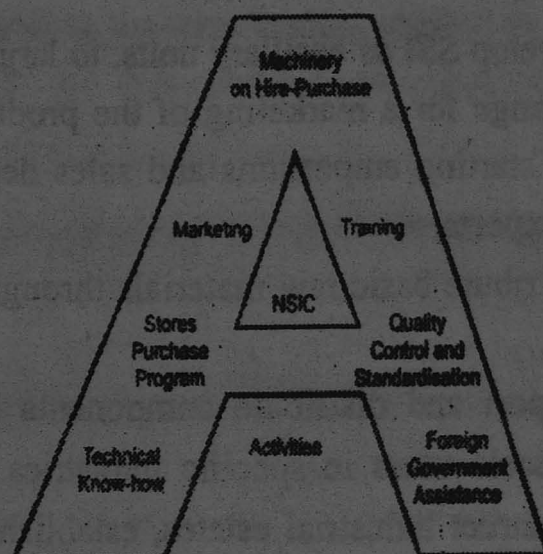


Fig. 3.1 Activities of NSIC

5. Commodity Boards (CB)

The Government of India, has setup eight commodity, boards, to guide the production and export of commodities along the right lines. The boards project the commodity image in the market in India and abroad and engage in research work. The eight commodity boards cover the following commodities.

(1) Coffee (2) Tea (3) Cardamon (4) Rubber (5) Coir (6) Silk (7) Handicrafts (8) Handloom.

The activities of the boards are with respect to the commodities specified above. They work on :

- (1) Promotion of exports.
- (2) Development of products
- (3) Co-ordination of the work to organise exhibitions abroad.
- (4) Undertake intensive promotional campaigns.

- (5) Research and development, surveys market analysis
- (6) Advisory role to government
- (7) Training seed production and sericulture activities.
- (8) Aid state government in execution of developmental schemes.
- (9) Rendering of technical assistance.

6. State Small Industries Corporations (SSIC)

Thirteen State Governments, have setup Small Industries Corporations as private limited bodies, to undertake number of commercial activities. The most important activities undertake by SSIC are :

- (1) Distribution of scarce raw materials.
- (2) Supply of machinery on hire-purchase
- (3) Construction and management of industrial estates.
- (4) Order procurement from Government departments to be sub-contracted to SSI.
- (5) Assistance in export-marketing.
- (6) Provision of financial, technical and managerial assistance in specific cases.

7. State Trading Corporation of India (STC)

The State Trading Corporation of India (STC) was established in May, 1956, as an autonomous corporation, to implement the government's policies in regard to the promotion and diversification of foreign trade.

Objectives of STC

- (1) To explore new markets for existing as well as new products
- (2) To diversify and consequently increase India's export trade.
- (3) To promote long-term export operations and the sale of "difficult-to-sell items".

Thus, the activities of STC encompass exports, imports and internal trade. To aid the corporation and to do better justice to the purpose for which it has been established, STC has set up four other subsidiaries namely :

- (1) The Projects and Equipment Corporation (PEC)
- (2) Handicrafts and Handlooms Export Corporation of India (HHEC)
- (3) The Cashew Corporation of India (CCI)
- (4) The State Chemicals and Pharmaceuticals Corporation Ltd. (SCP).

The above subsidiaries, assist the parent corporation in furthering the main objectives of export promotion.

8. Export Houses :

(EH) Export houses, are those which direct their energies towards export promotion. They are recognised and reputed houses of exporters. The origin of export houses in India goes back to 1958, when the Government gave serious consideration to the development of specialised agencies for the promotion of the non-traditional items.

Annexure I**APPLICATION FOR FINANCIAL ASSISTANCE**

The Central Financial Institution have prescribed a common application form which seeks information along the following lines.

1. General

Name, form of organisation; date of incorporation / registration; date of commencement of business, sector, business house to which the concern belongs, applicability of the MRTP Act: location, nature, of product (new / expansion / modernisation / diversification) brief particulars of the project, nature of industry and products, financial assistance applied for and foreign currency loan / guarantee applied for.

2. Promoters

Bio-data of the main promoter, brief write up on other companies promoted by the promoter in case the promoter is a limited company, a brief write up on the activities and past performance of the company.

3. Particulars of the Industrial Concern

Brief history, list of subsidiaries, particulars of holding company, details of directors, certified copies of audited balance sheets and profit and loss account for the last five years and brief explanations for year to year variations in production, sales, stocks, profits etc., and contingent liabilities, details of asset revaluation, if any during the existence of the company and the reasons thereof, list and bio-data of existing key tech-

nical and executive staff and number of supervisory, skilled, semi-skilled and unskilled personnel, organisation chart showing the lines of authority, existing long-term and short term borrowings as set out in forms II and III, company's tax status, manufacturing facilities separately at each plant, figures of licensed capacity, installed capacity, production and sales (quantities and value of net of excise duty) of each major product / product group during the last five years, locational advantage of existing plant, existing requirements of various utilities and services and the arrangements for their supply, details of export sales (and export incentives) in each of the last five years, details of insurance, details of pending litigation, details of research and development activities of the company, preventive maintenance adopted by the company.

4. Particulars of the project

Details of the project for which financial assistance is required in terms of the following (copy of the project report / feasibility report, if any to be enclosed).

(a) Capacity : Present installed capacity, maximum production achieved, proposed installed capacity, and maximum production envisaged for various products, section-wise capacities for the major sections of the plant, specifications of major products and by products.

(b) Process : Details of technical process, labour intensiveness of the process, advantages and disadvantages of the alternative process with

reference to employment potential; reasons for choosing the particular process, copy of process flow chart with material balance, utilities and process parameters, application of the proposed process in the country.

(c) Technical Arrangements : Technical arrangement made/proposed, write-up on collaborator in-case of collaboration, copy of collaboration agreement, copy of the government approval of the collaboration, copy of government approval for availing of the services of foreign technicians, particulars of consultants.

(d) Management : Proposed arrangement for executive management, particulars of proposed key technical administrative and accounting personnel, proposed organisation chart, proposed cost and budgetary control system, management reporting and inventory control system, purchase of raw materials, components, etc.

(e) Location and Land : Location of the plant, land requirement and the arrangements thereof, locational advantages, particulars in respect of the land acquired/proposed to be acquired, copy of sale/lease deed, copy of soil test report, copy of government order converting the land into industrial land if applicable, location map, site plan, etc.

(f) Buildings : Arrangements made/proposed for constructing of the buildings (particulars of buildings as per Form V), copy of master plan showing location of buildings and roads, power receiving station, railway siding, tube well, etc. Copy of equipment layout or plan of buildings, indication of flow of materials, particulars of architect, copy of agreement with architects, copy of published write up/brochure on architects.

(g) *Plant and Machinery* : Basis of selection of equipment, list of imported and indigenous plant and machinery acquired/to be acquired along with detailed specifications as per Forms VI and VII layout of the plant and machinery indicating the flow of materials.

(h) *Raw Materials* : Requirement of raw materials, components, chemical etc., as per Form VII, price or distribution controls if any on any of the items listed above, detailed note on the arrangements made for obtaining raw materials/chemicals, mining lease if any and details thereof, copy of agreement for mining lease and expert's report regarding the quantity and value of the reserves.

(i) *Utilities* : Details about power (sources of power and supply voltage, maximum demand, connected load, peak hour requirements, contracted load, power tariff cost of power) copy of letter, sanction for power copy of agreement with Electricity Board, copy of electrical layout of the plant, a note on power generation, demand and supply of power in the State present and projected, details about water layout for water system, copy of letter of sanction of water by municipal/local authorities where applicable copy of water analysis report, details for steam layout of the steam system, details for compressed air, fuel etc., copies of letter of allotment of coal/furnace oil from the concerned authorities, details for transport (arrangements a proposed for carrying raw materials and finished goods, provision for own trucks, railway siding, etc. and arrangements with private truck operators indicating rates subsidy if any available etc.)

(j) *Effluents* : Details of the nature of atmosphere, soil and

water pollution, likely to be created by the project and the measures proposed for control of pollution, permissions for the disposal of effluents where necessary, copy of approval from concerned authorities for the proposed arrangements.

(k) *Labour* : Estimates of total requirements and availability of skilled and unskilled labour, plans for training of personnel, manpower development programme, category wise, classification of total personnel requirements.

(l) *Quarters and Labour Housing* : Existing and proposed arrangements for housing staff and workers, classified as senior executives, other executives, supervisors and labour

(m) *Schedule of Implementation* : Manner in which the design, engineering, erection, installation and commissioning of the projects will be carried out, progress made so far in the implementation of the project schedule of implementation showing the commencement and completion of the following : acquisition of land, development of land, civil works, placement of order and delivery at site, of plant and machinery, arrangements for power, arrangements for water, erection of equipment, commissioning, procurement of raw materials and chemicals, training of personnel trial runs and commercial production, PERT chart, etc.

(n) *Other projects of the concern* : Details of any other new/expansion/modernisation etc, projects which are under implementation or which the company/promoters propose to implement, giving the estimated cost, means of financing and the present status.

5. Cost of the Project

Estimate of cost of project under the following heads :

- (i) land and site development,
- (ii) buildings;
- (iii) plant & machinery (imported and indigeneous)
- (iv) technical know-how fees;
- (v) expenses on foreign technicians and training of Indian technicians abroad;
- (vi) miscellaneous fixed assets ;
- (vii) preliminary and pre-operative expenses;
- (viii) provision for contingencies;
- (ix) margin money for working capital;

Basis of cost estimate bringing out the built in provision, for cost escalation if any, estimates of contingency/escalation provisions as per form IX-A and margin money for working capital as per Form IX-B.

3. Means of Financing

Means of financing envisaged is divided as follows : share capital (equity and preference) rupee basis, foreign currency loans, debentures, internal cash accruals and others, details of the means of financing envisaged and the proposals for raising share capital as per Form X and Form XA respectively basis of estimation of internal accruals, arrangements made so far for raising the finance and the proposed arrangements, copies

of letter sanctioning assistance, sources of foreign exchange and arrangements. If any made for obtaining foreign exchange, sources from which expenditure already incurred has been financed as per Form XB, promoter's contribution to project cost, list of persons/firms who would be contributing to the promoter's share of the capital and the respective amounts, details of security proposed to be offered for loan and/or guarantee for deferred payments on plant and machinery or guarantee for foreign currency loans, copy of letter from bank, indicating its willingness to guarantee a loan, in case a bank guarantee is proposed to be offered instead of mortgage of fixed assets.

7. Marketing and Selling Arrangements

Copy of market survey report, if any conducted on the company by Independent Consultants, brief notes on the products, their major uses, scope of the market, possible competition from substitute products, etc., special features (regarding quality, price etc.) of the product which would result in consumer preference in relation to competitive products, detailed notes on the existing and future demand and supply of the products proposed to be manufactured, assessment of likely competition in the future and special features of the project which may enable it to meet the competition, export possibilities and the nature of competition to be faced in foreign countries, comparative data on manufacturing costs and prices, in selected competing countries, export commitments of the company as

part of the government requirements and arrangements proposed for meeting the same, export incentives available, international CIF, FOB prices and landed costs of the proposed products, list of principal customers and particularly of any firm arrangements entered into with them, particulars of any firm arrangements entered into with them, particulars of government controls, restrictions etc., if any, on the sale price, distribution import export etc., in respect of the products proposed to be manufactured, nature of selling arrangements (direct through distributors or through selling agents) nature of proposed selling arrangements both in India and abroad and commission proposed to be paid, brief note on the selling agents organisation, copy of the agreement with selling agent, particulars of any sole selling agency, where imposed for any of its products, details regarding the trend in prices during the last five years, the basis on which prices are fixed, if the prices are controlled by the government or on a voluntary basis, in case of agro-based agriculture input industries the company's scheme for educating the farmers to use the product, to grow the produce required.

8. Profitability and Cash Flow

Estimates of cost of production and working results for the first ten years of operation as per Forms XI and XII respectively for expansion/diversification of existing companies, two sets of profitability statements

may be prepared are for the project and the other for the existing operations only; cash flow statement for the company as a whole for ten operating years of the project in Form XIV based on working results in Form XII projected balance sheet for ten operating years for the company as a whole as per Form XV ; break even capacity level.

9. Economic Considerations

Prices of competing import/export products giving a breakup as FOB, CIF, landed cost (including import duty) and selling price, detailed explanation for difference in selling prices of the products and those of imported goods with quantitative data on differences in cost of production (such as scale of operation, differences in costs of inputs, which can either be imported/exported, details of duties, taxes and incentives (excise duty, duty drawback, cash subsidy, any other, brief write up on the economic benefits to the country in general and the region in particular, on account of the proposed project, contribution of the unit to the establishment of ancillary industries in the region.

10. Government Consents

Details of the following licences / consents required for the project in terms of date of issue, validity period and present issue, if not already issued, (i) letter of intent, (ii) industrial license, (iii) capital goods clearance, (iv) import license, (v) foreign exchange permission, (vi) approval of technical/financial collaboration, (vii) clearance under MRTTP

Act, (viii) any other, copies of licences/consents etc., received, special conditions attached to the licences/consents and undertakings given by the company in connection with them.

11. Declaration

A declaration by the applicant that the information statements and papers furnished, are true and correct.

List of Forms

The following is the list of forms duly filled in, to be submitted along with the Application for Financial Assistance.

- I) The letter addressed to the bankers.
- II) Existing long term borrowings.
- III) Existing short term borrowings.
- IV) Distribution of share holdings
- V) Particulars of buildings.
- VI) Particulars of imported machinery.
- VII) Particulars of indigenous machinery.
- VIII) Raw materials requirements.
- IX) Estimates of cost of project
- IXA) Calculation of contingency
- IXB) Calculation of margin money
- X) Means of financing.
- XI) Estimates of cost of production
- XII) Estimates of production and sales

- XIIA) Estimates of working results
- XIIB) Calculation of wages and salaries
- XIV) Cash flow statement
- XV) Projected balance sheet

Annexure II

PROCEDURE AND REVIEW OF TERM LENDING FINANCIAL INSTITUTIONS

Term lending financial institutions provide the bulk of debt finance, required for industrial projects. What is the procedure followed by these institutions? What kind of review is done by them? This note seeks to answer these questions primarily with reference to All India-Term Lending Financial institutions.

Term Loan Procedure

1. Submission of Loan Applications

The borrower may submit the application to any of the three term lending institutions viz., IDBI, ICICI, and IFCI. The borrower is required to fill out a common application form which seeks comprehensive information about the project, specifically covering the following aspects, viz :

- (1) Promoters background
- (2) Particulars of the industrial concern.
- (3) Particulars of the project (capacity, process, technical arrangements, management, location, land and buildings, plant and machinery, raw materials, effluents, labour, housing and

schedule of implementation.

- (4) Cost of the project.
- (5) Means of financing.
- (6) Marketing and selling arrangements.
- (7) Profitability and cash flow.
- (8) Economic considerations.
- (9) Government consents.

2. Initial Processing of Loan Application

When the application is received, an officer of the recipient institution reviews it to ascertain whether it is complete for processing. If it is incomplete, the borrower is asked to provide the additional information. When the application is considered complete, the recipient institution prepares a flash report which is essentially a summarisation of the loan application to be evaluated at the Senior Executive Meeting (SEM). Once the SEM, on the basis of its evaluation of the 'Flash Report' decides that the project justifies a detail appraisal it nominates the lead financial institution in the estate and existing work load of the institution.

For the convenience of the borrowers, financial institution operate a scheme of participation for rupee term loans and underwriting assistance. Under this scheme, the borrower interacts with only the lead financial institutions which administers the entire loan and under-writing facility. The lead institution, exercises the right of other participating institution as their constituent authority.

3. Appraisal of the Proposed Project

The detailed appraisal of the project is done by the lead institution. The appraisal covers the marketing, technical, financial, managerial and economic aspects. The appraisal memorandum is normally prepared within two months after site inspection and placed before the Senior Executive Meeting/Inter Institutional Meeting (SEM/IIM) about approval of the project and determining the sharing arrangement among the institution. Once a favourable decision is taken at the SEM/IIM forum and the sharing arrangement worked out, the case is referred to the Board of Directors of the lead financial institution.

4. Issue of the Letter of Sanction

After the Board of Directors of the lead financial institutions approves the proposal, a formal letter of sanction, is issued to the borrower. This communicates to the borrower the assistance sanctioned by the lead institution and the assistance sanctioned / to be sanctioned by other participants in the consortium arrangement. Each of the participating institutions would after approval by its Board of Directors or other appropriate authority convey-sanction of its share of assistance to the lead institution and advice the borrower too. If a participating institution is not able to make available its share of assistance, the same will be shared on a pro-rata basis amongst the lead and other participating institutions.

5. Acceptance of the Terms and Conditions by the Borrowing Unit

On receiving the letter of sanction, from the lead financial

institution the borrowing unit convenes its board meeting at which the terms and condition associated with the letter of sanction are accepted and an appropriate resolution is passed to the effect. The acceptance of the terms and conditions has to be conveyed to the lead financial institution within thirty days.

6. Execution of Loan Agreement

The lead financial institution after receiving the letter of acceptance from the borrower, sends the drafts of the agreement to the borrower to be executed by authorised persons and properly executed and stamped, along with other documents as required by the lead financial institution must be returned to it. Once the lead financial institution also signs the agreement, it becomes effective.

7. Disbursement of Loans

Periodically, the borrower is required to submit information on the physical progress of the project, financial status of the project, arrangements made for financing the project, contribution made by the promoters, projected funds flow statement, compliance with various statutory requirements and fulfillment of pre-disbursement condition. Based on the information provided by the borrower, the lead financial institution will determine the amount of term loan to be disbursed from time to time, before the entire term loan is disbursed the borrower must fully comply with all the terms and conditions of the loan agreement.

8. Creation of Security

The term loans (both rupee and foreign currency) and deferred payment guarantee assistance provided by the All India Financial Institution are secured through the first mortgage by way of deposit of title deeds of immovable properties and hypothecation of movable properties as the creation of mortgage particularly in the case of land, tends to be a time consuming process, the institution permits interim disbursement against alternate security (in the form of guarantees by the promoters). The mortgage, however, has to be created within a year from the date of the disbursement. Other-wise the borrower has to pay an additional charge of one percent interest.

9. Monitoring

Monitoring of the project is done in the implementation stage as well as the operational stage. During the implementation stage the project is monitored through :

- (1) Regular reports furnished by the promoters which provide information about placement of orders, construction of buildings, procurement of plant, installation of plant and machinery, trial production etc.,
- (2) Periodic site visits;
- (3) Discussion with promoters, bankers, suppliers, creditors and other connected with the project;
- (4) Progress reports submitted by the nominee directors; and
- (5) Audited accounts of the company.

During the operational stage the project is monitored with the help of:

- (1) Quarterly progress report on the project;
- (2) Site inspections;
- (3) Reports of nominee directors;
- (4) Comparison of performance with what was stated;

The most important aspect of monitoring, ofcourse is the recovery of dues, represented by interest and principal repayment.

Review

Financial Institutions review a project from the financial, economic, technical, marketing and managerial points of view. The issues considered and the criteria employed in such review are discussed below.

Financial Review

The financial review seeks to determine that there is :

- (i) Reasonableness of the estimate of capital cost.
- (ii) Reasonableness of the estimate of working results.
- (iii) Adequacy of the rate of return.
- (iv) Appropriateness of the financing pattern.

Reasonableness of the Estimate of Capital Cost

While assessing the capital cost estimates, efforts are made to ensure that :

- (i) Padding or underestimation of cost is avoided.
- (ii) Specification of machinery is proper.

- (iii) Proper quotations are obtained from potential suppliers.
- (iv) Contingencies are provided.
- (v) Inflation factors are considered.

Reasonableness of Estimate of Working Results : The estimate of working results is sought to be based on :

- (i) Realistic market demand forecast
- (ii) Price computation for inputs and outputs that are based on current quotations and inflationary factors.
- (iii) An appropriate time schedule for capacity utilisation.
- (iv) Cost projection that distinguish between fix and variable cost.

3. Adequacy of Rate of Return

The general norms for financial desirability are as follows :

- (i) Internal rate of return of fifteen percent
- (ii) Return on investment of twenty to twenty five percent, after tax
- (iii) Debts service coverage ratio 1.2:2

In applying these norms, however, a certain degree of flexibility is shown on the basis of the nature of the project, the risks inherent in the project, and the status of the promoter.

4. Appropriateness of the Financing Pattern

The institutions consider the following in assessing the financing pattern:

- (i) A general debt equity ratio of 2:1.

- (ii) Requirement that promoter should contribute twelve and half percent to twenty two and half percent, of the project cost.
- (iii) Stock exchange listing requirement.
- (iv) The means of the promoter and his capacity to contribute reasonable share, of the project finance.

Economic Review

The economic review looks at the project from the larger social point of view. The methodology adopted by the financial institutions for the purpose of economic evaluation is labelled as "Partial Little-Mirrlees" approach. In addition to the calculation of the economic rate of return, as per this approach they also look at two other economic indicators i.e. effective rate of protection, and domestic resource cost.

Admittedly, the economic review done by financial institutions is not very rigorous and sophisticated. Also, the emphasis placed on this review is rather limited, yet a beginning has been made. Hopefully on the basis of the experience gained the methodology would be improved and the emphasis increased, in times to come.

Technical Review

The technical review done by the financial institutions, focuses mainly on the following aspects :

Technical Review : The technical review done by the financial institutions, focuses mainly on the following aspects:

- (1) Product mix

- (2) Capacity
- (3) Process of manufacture
- (4) Engineering know-how and technical collaboration
- (5) Raw materials and consumables.
- (6) Location and site
- (7) Building
- (8) Plant and equipments
- (9) Manpower requirements
- (10) Break-even point

The technical review is done by qualified and experienced personnel available in the institutions and/or outside experts (particularly where large and technologically sophisticated projects are involved).

Marketing Review

The importance of potential market and the need to develop a suitable marketing strategy cannot be over emphasised. Hence, efforts are made to :

- (1) Examine the reasonableness of demand projections by utilising the finding of available surveys, Industry Association Projections, Planning Commission/DGTD, Projections and Independent Market Surveys.
- (2) Assess the adequacy of marketing arrangements in terms of promotional effort, distribution network, transport facilities, stock levels, etc.

- (3) Judge the knowledge, experience and competence of key marketing personnel.

Management Review

In order to judge the managerial capability of the promoters the following questions are raised.

- (1) How resourceful are the promoters?
- (2) How sound is the understanding of the project by promoters?
- (3) How committed are the promoters?

Resourcefulness

This is judged in terms of the prior experience of the promoters, the progress achieved in organising various aspects of the project and the skill with which the project is presented.

2. Understanding

This is assessed in terms of the credibility of the project plan (this includes inter-alia the organisation structure, the estimated costs, the financing pattern, the assessment of various inputs, and the marketing programme and the details furnished to the financial institutions).

3. Commitment

This is gauged by the resources (financial, managerial, material and other) applied to the project and the zeal with which the objectives, short term as well as long term are being pursued.

Managerial review also involves an assessment of the calibre

of the key technical and managerial personnel working on the project, the schedule for training them and the remuneration structure for rewarding and motivating them.

Sources of Finance

When seeking money for business, one need not look at the easily available sources, but must explore possible sources and then decide about the most suitable and proper mix of getting finance.

A major problem that entrepreneurs face is either lack of knowledge, about sources of fund or inability to decide from where to get funds.

Though availability of funds would be the main criteria, for an entrepreneur, about sources of fund or inability to decide from where to get funds.

Though availability of funds would be the main criteria, for an entrepreneur, the terms and procedures involved in procuring these funds, need to be carefully examined in deciding the effectiveness and usefulness of those funds.

In deciding about sources of finance one must consider:

- (1) Cost of funds
- (2) Time factors : (a) Period for which fund are needed (b) Time taken to obtain money.
- (3) Purpose for which funds are needed.
- (4) Governmental regulations and norms of financial institutions.

(5) Repayment capacity and pattern.

Sources of finance can be divided under:

- (1) Internal sources
- (2) External sources

Exhibit I : Sources of Finance

Internal	External
(a) Own Savings and Investment	(a) Term-Loan, long term loan
(b) Personal loans from PF/LIC/ Co-operative Bank etc.	(b) Short term loan
(c) Personal borrowings from relatives and friends.	(c) Plant leasing
(d) Money raised through mortgage of personal assets like shares, land, building etc.	(d) Hire-purchase
(e) Profit earned or transferred from existing business / investment or trade.	(e) Working capital loan

Exhibit II : Summary of Sources of Finance

Sl. No.	Category	Particulars	Source	Remarks
1.	Overdraft	Provides essential short term finance for requirement working capital,	Bank	Should not be used for of long term purpose

especially during
seasonal fluctuations.

- | | | | |
|-----------------------------------|---|---|---|
| 2. Mortgage
Loans
plant and | For purpose of
land and buildings,
equipment | Finance
Companies
and
insurance
Companies | Secured on
first charge
on land and
buildings. |
| 3. Leasing
Finance | Available for lease of
plant and equipment
Generally for
economic life of
leased goods. | Banks,
Leasing
Companies. | Lease can
use productive
equipment
without
capital outlay.
Interest and
paid on lease
are deductible
expenditure. |
| 4. Hire-
Purchase | Used for financing
of purchase of plants
and equipment. | NSIC,
SSIC and
Finance
Companies | Ownership is
vested with the
lender. Interest
charged at
flat rate over
the life of loans.
Borrower
requires to keep |

			deposit on purchase of goods.
5. Bridging Finance	Interim form of finance secured against land or building.	Banks, Finance companies, SFC's	Useful only for short term. Interest rates higher than medium and short term loans
6. Commercial Bills	Short term finance used for bridging finance and seasonal fluctuations.	Banks, Private Discounting Agencies	Available only to enterprises with solid credit rating.
7. Loans	Secured by borrower's assets. These loans have wide variety of application. Shroffs	Banks, Finance Companies length of the (Private loan Lenders).	Interest charged at flat rate, medium term
8. Equity and Venture Capital (Debenture capital)	Source of equity fund medium to long terms. Debt capital usually with a provision for conversion in equity	Bank, State level Financial Institutions.	Low interest rate. Eligibility criteria is of product or experience.

i.e. convertible
debentures.

9. Working Capital	Various facilities of Banks. financial assistance to fund working capital requirements	Financial limits sanctioned, renewable annually.
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(Source : State Bank of India - Hand Book)

Management of Working Capital

Efficient use of capital is the essence of financial management. Management of capital has two aspects: management of capital employed in fixed assets and management of working capital. The aim of the former is effective use of capital in the purchase of fixed assets. e.g., plant and machinery, land and building, etc.

The purpose of working capital is to finance day to day operations of the firm i.e. maintenance of all current assets, such as cash, bank balance, stock, debtors, advance to suppliers etc. Working capital can be gross working capital or net working capital.

Gross working capital refers to total of current assets while as net working capital refers to excess of current assets over the current liabilities. In other words, net working capital is a part of working capital which is financed by long term sources of funds and this determines the margin of safety for meeting the current liabilities.

Working capital is also called circulating capital, since it stands for the amount being circulated in different current assets. Cash is used to purchase raw material, raw materials is converted into finished goods, finished goods into sales (cash or credit) and debtors into bills receivable and bill receivable into cash. The same cash takes the form of one asset or the other.

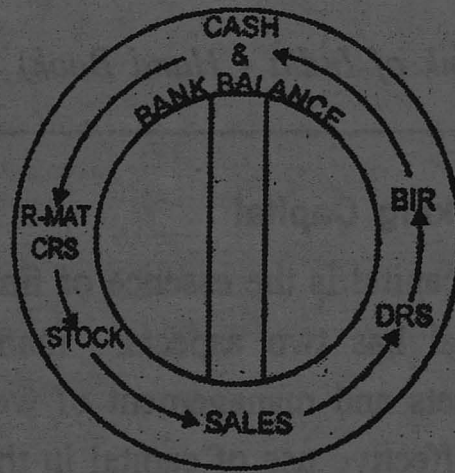


Fig. 3.2 Cycle of Working Capital

The management of working capital is significant for the following reasons :

- (a) Cost of working capital is higher, because of higher interest rate charged by the 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 situations, 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 firm has sufficient funds to meet its daily expenses on production, sales and other operations and at the same time, the firm does not block its capital in maintaining inventory in excess of what is required and 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. A firm has to estimate its working capital needs accurately and provide for it from its own sources or by way of outside borrowings.

Management of working capital includes

- (1) Operating cycle
- (2) Management of cash
- (3) Management of inventory
- (4) Management of receivables/sundry debtors
- (5) Resources planning for working capital

Operating Cycle

Operating cycle, is a circular flow in which cash is used to buy

raw materials, raw materials are converted into stock-in-process and finished goods by incurring the expenses for production. Finished goods are sold to the customers on credit and cash is blocked in the form of receivables. On realisation of the receivables the funds complete one cycle and become cash again to be used for purchase of raw materials. This cycle, continuously goes on and on, therefore at any given point of time, the working capital employed by a firm is the summation of the following :

- (a) Cash and bank balance
- (b) Value of raw material
- (c) Value of stock in process
- (d) Value of finished goods stock
- (e) Value of receivables

The entrepreneur or his finance person should design and control the quantum of above items scientifically and stringently. Operating cycle thus refers to "length of the period taken to cover the sequence of events-right from the purchase of inventory to their conversion into cash.

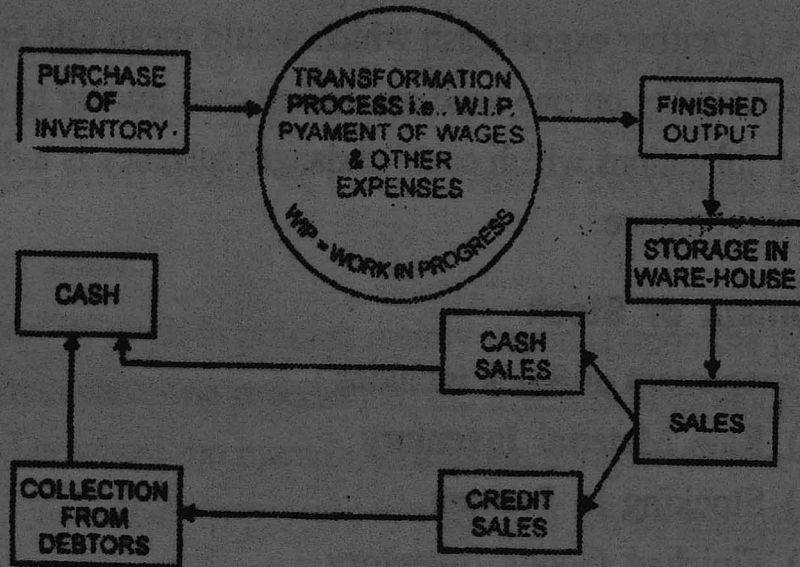


Fig. 3.3 Operating Cycle

Management of Cash

The size of cash balance that a firm should keep depends on the following factors :

- (a) Volume of transaction
- (b) Contingency needs
- (c) Opportunity needs
- (d) Availability of short term credits
- (e) Variation in cash

Cash management is one of the most crucial importance yet difficult aspect of working capital management. For an entrepreneur for whom cash is not only scarce but costly, cash management is vital. Monitoring of cash i.e., cash payments and receipts to ensure

that there is neither excess cash which would mean idle cash leading to loss of profitability on one hand and deficit cash leading to nonfulfillment of current obligations which could endanger solvency is a difficult task to manage and balance.

Management of Stock

Management of Stock includes :

- (a) Raw Material Inventory
- (b) Stocking-In Process
- (c) Finished Goods Inventory

(a) Raw Material Inventory

The volume of raw material inventory will depend upon the following factors :

- (i) Lead time of purchase i.e., time lag behind placing of order and actual receipt of materials.
- (ii) Minimum order quantity i.e., the minimum quantity a material is packed in or the supplier executes an order.
- (iii) Rate of consumption of raw materials.
- (iv) Ordering cost i.e., the cost of postage, stationary, telephone and visits to the supplier, which have to be incurred for placing an order. Higher the ordering cost, less will be the frequency of purchase and more will be volume of one purchase and hence the maximum raw material stock will be high.

- (v) Inventory carrying cost i.e., interest, rent of godown, cost of insurance are examples of inventory carrying cost. If this cost is high, effort should be made to reduce the volume of stock.

(b) Stock-in-process

The volume of stock in process mainly depends upon the period of completion of manufacturing process i.e., the investment in stock in process will be higher where the manufacturing/operating cycle time is long and vice-versa. The stock-in-process is also high where manufacturing processes involves use of several machines and capacity of those machines are not balanced.

(c) Finished goods

The volume of finished goods inventory depends upon the following factors :

- (i) Firms that produce in anticipation of sale will have to maintain higher stock of finished goods, than the firms who produce against specific orders. e.g. Godrej Refrigerator Vs HMT Lathes.
- (ii) Waiting time for inspection.
- (iii) Waiting time for railway wagon/road transport facilities.
- (iv) If delivery in large batch sizes, is wanted by the customer, then higher stock of finished goods will have to be maintained.
- (v) If optimum batch size, of production is large then finished goods stock will also be high.

Management of Receivables

The volume of receivables, depends upon the payment terms of the customers and their liquidity positions. It also depends upon the credit

Example : A firm selling in seller's market will follow a stringent credit policy and a firm in a competitive market may prefer a liberal credit policy.

An Example of a firm, in seller's market would be Monograph Printing Ltd., manufacturing printing machines. An example of a firm in competitive market would be BPL, Godrej etc.

Many firms offers cash discount (discount is allowed to customers if goods are paid in cash as soon as they are delivered). In such cases it has to be seen that the discount allowed (loss) is less than the cost of interest, on funds blocked in credit during the collection period.

Higher receivables, mean blockage of funds as well as risk of bad debts. On the other hand, credit, sometimes, is used as an instrument for promoting sales.

Resources for Working Capital

Small industries usually, has poor equity base i.e., capital invested initially. The amount of credit, they can manage from suppliers is also limited. In such cases, they have no other way than to borrow from commercial banks. As a unit operates profitably, more and

more of surplus generated should be ploughed back to working capital to reduce the dependence on borrowings and to finance the additional working capital, need for growth in future.

Costing

"How much does it cost?" is the most usual question we ask when we want to buy. What one really means is not the "cost" in the strict sense of the term but the selling price.

What then is the meaning of 'cost'? Is it the sum of the cost of raw material, labour power etc.? or is it something more than that?

Hence, it is necessary for entrepreneurs to understand the meaning of cost and costing, its importance and how to go about arriving at the 'cost of goods sold' that one manufactures or services one provides.

Ultimately one's cost price, determines selling price and selling price is the ultimate test of success. If the cost price is higher, then profits could be reduced because selling price could be dictated by competitors in the market. Hence the equation :

$$C.P + P.P = S.P \text{ or}$$

$$S.P - C.P. = P.P$$

Where S.P = Selling Price

C.P = Cost Price

P.P = Profit Percent

Professional accountants defines costing as "the process of classifying, recording and appropriately allocating expenditure for determination

of cost of the products or services" In simple terms, costing is "the process of determining how much it costs to produce and sell a given product or service".

Understanding and recording of cost and costing is crucial for new entrepreneurs, so that anything that happens to a unit in terms of cost, can be controlled or improved, and this is possible only if proper records and system of costing is adopted. Unfortunately, many times entrepreneurs realise this only after costs have been incurred and it is too late for rectification.

Types of Cost

From the definition of costing, it is clear that merely cost of producing a given item is not the criteria but also cost involved in distributing/selling it, is to be taken into consideration.

Example : When we talk of products like typewriter, washing machines, apart from cost of manufacturing, distributing and selling another cost component would be cost of after sales service. Thus, it is necessary to understand various component of cost. The basic components of costs are, direct cost and indirect cost.

1. Direct Cost

It refers to those items of cost that can be attributed directly to the end product. e.g. : Cost of yarn in manufacturing textiles is a direct cost. In other words cost of those items that become part of end product are termed as direct cost. The two items of direct cost that can

be easily identified with the end product are material cost and labour cost

2. Indirect Cost

It refers to all those items of cost, that are incurred in running a business and those that cannot be identified independently, with the end product directly.

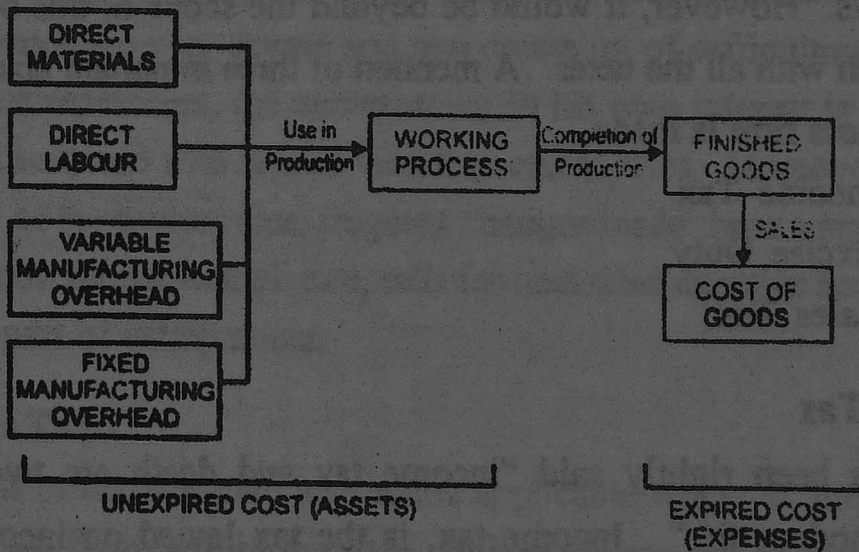


Fig. 3 : Flow of cost

Thus, when an entrepreneur is proposing to set up a business it is essential at the outset to list down all the items of cost and systematically record them as and when incurred. Further, a careful segregation of costs into direct and indirect cost is required so as to derive properly the total cost of one product.

Costing details not only help in pricing product, but also facilitate in knowing which product manufactured is more profitable than others. It also helps in deciding 'product mix' and aids in deciding whether, 'to make or buy' a product.

Notes on Taxation

Business enterprises and businessmen are subject to various statutes and tax laws. However, it would be beyond the scope of this book to deal in depth with all the taxes. A mention of three important taxes, that affect business firm is made.

- (1) Income Tax
- (2) Excise Duty
- (3) Sales Tax

1. Income Tax

It has been rightly said "income tax and death are two sure things in modern life". Income tax, is the tax levied on income as defined by Income Tax Act, 1961. It is an annual tax collected by the Central government for each financial year on the total income of the previous year. The financial year of the Central government is from 1st April to 31st March, and therefore the taxes have to be paid for each assessment year, on the income of the previous year relevant to it. The income tax rates are decided by the Central government every year while presenting the budget. Filing of income tax returns and

payment of tax is statutory obligation for an entrepreneur, if his income and business turnover, exceeds the specified limits.

2. Excise Duty

Excise is a tax levied by the Central government. This tax is applied for the clearance of goods from the factory. The rate of exercise depends upon items manufactured, and these rates vary as per the decisions of the government. Since the penalties under the excise tax for non-compliance are very severe and can create lot of difficulties for enterprises/entrepreneurs, the entrepreneur in his own interest is advised to consult someone who is well versed in excise rules. Moreover the complexity of the excise rules, frequent changes made therein and the magnitude cost for non-compliance, calls for undivided attention and discipline on the part of entrepreneur.

3. Sales Tax

Sales tax is a state levy made applicable wherever the goods are purchased from, within the state. When the goods are procured from outside the state, Central Sales Tax (CST) is levied. Since it is the duty of the seller to charge sales tax and hand it over to the government, a businessman has to acquaint himself with the broad outlines of the sales tax.

Since sales tax is levy by state, it could differ from state to state. However an entrepreneur, irrespective of the state in which he undertakes, to do business, should register his business and obtain a CST/ST

number. Further he should also file return for sales tax.

Small Industries Service Institutes (SISI)

Small Industries Service Institutes are imparting training to young Engineers :

All Small Industries Service Institutes :

Bombay, Calcutta, Madras, Ludhiana, New Delhi, Cuttack, Ahmedabad, Bangalore, Trichur (Kerala), Patna, Jammu, Jaipur, Hyderabad, Kanpur, Gauhati, Marmagao and Indore.

Non-Government Institutions designated for training of young Engineers :

SIET-Hyderabad; Motilal Nehru Regional Engg. College, Allahabad; P.D.T.C. Howrah; P.D.T.C. Okhla, New Delhi; Punjab Engg. College, Chandigarh; Gujarat Industrial Investment Corporation, Natraj Chambers, Ahmedabad; IIT, Hauz Khas, New Delhi; IIT, Kanpur.

Small Industries Service Institute, New Delhi, has recently brought out a publication containing project profiles on 'Electronics Industry'. It proposes to publish similar publications on 'Mass Consumption Industry', 'Chemical and Allied Industry' and 'Engineering Industry'.

National Productivity Council, (NPC) New Delhi

Recently National Productivity Council has started a Package Consultancy Service to Small Industries. This service is in three stages: viz,

- a) Train young and prospective entrepreneurs;

- b) Undertake market surveys in the State/areas for identifying investment opportunities and consumption patterns for the prospective entrepreneurs; develop data bank for providing information in respect of investment opportunities and financial resources required, facilities available for obtaining loans; selection/modernisation of processes and equipment; product development; availability of raw materials and market opportunities, sales promotion and marketing; and to undertake techno-economic feasibility studies either on behalf of prospective or existing entrepreneurs or on behalf of financial institutions;
- c) Post-investment service-consultancy and follow-up in the following form:

To assist the entrepreneurs in repayment of loans in the minimum possible time by helping them in improving their enterprise level productivity through periodical visits; assist the small scale industries in training of workers in specific trades and supervisory and managerial personnel in techno-managerial subjects; assist the existing enterprises in improving their enterprise level productivity through training and consultancy services; and assisting them in market studies and sales promotion.

Capital investment refers to investment in fixed assets or long term assets which yield a return over a period of time, usually exceeding one year. Capital investment is necessary for replacement of fixed assets, expansion and diversification of business, research and

development and the like. A firm has to take a number of capital investment decisions. The capital investment decision is widely known as capital budgeting or capital expenditure decision.

Meaning of capital budgeting

A capital budgeting decision may be defined as the firm's decision to invest its current funds most efficiently in the long term assets in anticipation of an expected flow of benefits over a series of years. The capital budgeting decision involves a current outlay or series of outlays of cash resources in return for an anticipated future benefits. In other words, capital budgeting is employed to evaluate expenditure decisions which involve current outlay which are likely to produce benefits over a period of time. The benefits may be in the form of increased revenue or reduction in cost.

The following are the features of capital budgeting.

- a) The exchange of current funds for future benefits.
- b) The funds are invested in long term funds.
- c) It has the potentiality of making large profits.
- d) It involves a long period of time period between the initial outlay and the anticipated return.

Importance of capital budgeting

Capital budgeting decisions are of great importance in business decisions. The following points highlight the importance of capital budgeting.

- a) Capital budgeting decisions require huge capital outlays. So it has a decisive influence on the rate and direction of the growth of the firm. An appropriate decision can give a higher return where as a wrong decision can endanger the survival of the firm.
- b) The investment decisions, once made, are irreversible in most cases. It can either be scrapped or sold at substantial loss to the firm.
- c) Capital budgeting decisions involve huge funds. A majority of the firms have limited resources. So, capital budgeting should be made with utmost care.
- d) Capital investment decisions require assessment of future events which are difficult to predict. So estimation is a difficult task.
- e) Capital budgeting decisions affect the profitability and the competitive position of the firm. It determines the destiny of the company. This underlines the need for correct investment decisions.

Types of capital budgeting decisions

Capital budgeting decision can be of two types

- a) Decision that increases revenue
- b) Decision that reduces cost

Decision that increases revenue

Certain investment decisions are expected to bring additional revenue. For instance, expansion of the present operations or development of a new product line may result in additional returns. In both the cases investment is to be made in new fixed assets.

Decision that reduces cost

When an asset becomes outdated or obsolete, the firm must decide whether to continue with the existing one or replace it by a new machine. The firm evaluates the benefits from the new machine in terms of total savings. The firm will replace the machine only when it results in savings and increase in the total earning of the firm.

Kinds of capital budgeting decisions

Basically there are three types of capital budgeting decisions

- a) Accept - reject decision
- b) Mutually exclusive project decision
- c) Capital rationing decision

Accept reject decision

This type of decision is applicable to independent projects i.e. projects which do not compete with each other. Under the accept reject decision, the proposals which yield a rate of return higher than a required minimum rate of return are accepted and others are rejected.

Mutually exclusive project decision

Mutually exclusive projects are projects which compete with each other. The acceptance of one project will exclude the acceptance of other projects. For instance, a company proposes to buy a new computer. There are various brands of computers with different investment. The various brands of computers represent mutually exclusive alternatives. One among them will be selected and others rejected. Certain methods are evolved to select the best among the various alternatives.

Capital rationing decision

In a situation, where a large number of investment proposals compete for a limited funds, capital rationing decision is applied.

In capital rationing, investment proposals are ranked on the basis of some predetermined criterion. The projects are ranked in the descending order of the rate of return. The firm allocates funds to projects in the order of rank so that it will maximise return in the long run.

Factors affecting capital decision

The following factors affect the capital budgeting decision.

a) Cash flows

The requirement to evaluate any investment proposal is estimation of cash flow.

b) Incremental cash flow

The second aspect relates to the basis on which the cash flows are to be estimated. In practice incremental cash flows i.e. those cash flows

which are directly attributable to the investment, are considered.

c) Effects of taxes

Taxes paid are deducted from the cash flows to estimate the benefit arising out of the proposed investment.

d) Cash inflow estimates

For estimating the cash inflows the following ingredients are to be taken on to account.

e) Taxes

The cash flows are adjusted for tax liability. The net cash flows are considered for capital budgeting decision.

f) Effect on other projects

While estimating the cash inflows, the effect on the cash flows of other projects should be considered. For instance, a company proposes to introduce a new product which may affect the actual cash flow from the existing product. This should be taken into account while estimating the cash inflows from the new products.

g) Indirect expense

The amount of indirect expenses should also be taken into account if the overhead changes as a result of the investment decision.

Working capital

Investment in new project results in change in the net working capital. For example, if the sales is increased as a result of new investment, it will be followed by an increase in current assets in the form of

larger inventory, larger account receivable and also cash. The increase in current assets may be offset by increase in current liabilities. An amount equivalent to the difference between current assets and current liabilities will be needed as a part of total investment a project. This increased working capital which forms part of initial cash outlay will be recouped at the end of the project's life. This amount of working capital will form part of the cash inflow in the last period.

Cash outflow estimates

The term net cash outflow refers to the sum of all outflows and inflows occurring at zero time period. The net outflow is determined by considering the following factors.

- a) Cost of new project
- b) Installation charges
- c) Working capital
- d) Proceeds from sale of assets
- e) Taxes from sale of assets
- f) Investment allowance

The initial outlay for a new project includes cost of the project, Installation cost and working capital. To calculate the initial outflow in case of replacing the existing machine, the factors such as proceeds from sale of assets and taxes on sale of assets are to taken into account. The cash realised from the sale of old assets will reduce the cost of new investment. The amount of profit or loss on the sale of the assets may affect the cash flows on account of tax on sale of assets. The investment

allowance is allowed to encourage investment in machinery and investment. An amount equal to investment allowance is deducted from income to arrive at taxable income. The savings in tax reduces the cost of the initial investment of the project.

Computation of cash outflows

Illustration 1

A company is considering replacement of its existing machine by a new machine. The cost of new machine is Rs. 1,60,000. The cost of installation is Rs. 5,000. The old machine was purchased at a cost of Rs. 60,000 two years ago. The depreciation is written off at straight line method. The machine has a total life of 6 years. The company is subject to 50% income tax and 30% tax on capital gains. Compute the cash outflows.

Net cash proceeds from sale of old machine

Sale Value 70,000

Book value 40,000 (less depreciation)

Total profit 30,000

Capital gain = Sale price - Original price

= 70,000 - 60,000

= 10,000

Profit † = Total profit - Capital gain

= 30,000 - 10,000

Tax on

Profit (50%) = 10,000 viz (20,000 * 0.5)

Capital gain (30%) = 3,000

= 13,000

Net proceeds = Sales price - taxes

= 70,000 - 13,000

= 57,000

Net case outflows

Rs.

Cost of machine = 1,60,000

Cost of installation = 5,000

1,65,000

Cash proceeds from

sale of machine = 57,000

1,08,000

Computation of cash inflows

Illustration 2

A company has net inflows before depreciation and taxes with a proposed capital expenditure. The company has a machine that will be depreciated at the rate of Rs. 5,000 over the next five years. The company is in 50% tax bracket. Determine the incremental cash inflows of the machine.

Estimate cash inflow

Year	Amount
1	75,000
2	80,000

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3	85,000
4	1,00,000
5	1,10,000

Incremental cash inflows

Year	Cash flow before tax (1)	Depreciation (2) = (1)-(2) (2)	Taxable income (3)	Tax (4)	Cash flow after tax (5)=(2+1)
1	75,000	5,000	70,000	35,000	40,000
2	80,000	5,000	75,000	37,500	42,500
3	85,000	5,000	80,000	40,000	45,000
4	1,00,000	5,000	95,000	47,500	52,500
5	1,10,000	5,000	1,05,000	52,500	57,500

Methods of appraisal

The following are the methods used to appraise investment proposals

- 1) Pay back period method
- 2) Average rate of return method
- 3) Discounted cash flow method
 - a) The net present value method
 - b) Present value index method
 - c) Internal rate of return method

Pay back period method

The pay back period method is the traditional and widely recog-

nized method of appraising investment proposals. The term pay back refers to the number of years required to recoup the initial investment made in a project.

There are two methods of calculating pay back method

Cash flows are uniform

When cash flows are uniform, the pay back period is calculated by dividing the initial cost of investment by annual cash inflow.

$$\text{Pay back period} = \frac{\text{Initial investment}}{\text{Annual cash inflow}}$$

Illustration 3

A project requires an investment of Rs. 50,000. It is expected to produce annual cash flow of Rs. 10,000 for 8 years. Calculate the pay back period.

$$\text{Pay back period} = \frac{50,000}{10,000} = 5 \text{ years}$$

Cash flows are not uniform

In case of unequal cash inflows, the pay back period is calculated by cumulating the cash flows until the total is equal to the initial investment.

Illustration 4

A project requires an initial investment of Rs. 40,000. The annual cash flows for six years are Rs. 8,000, 12,000, 15,000, 10,000 and Rs. 9,000. Calculate the pay back period.

Year	Annual Cash flows	Cumulative Cash flows
	Rs.	Rs.
1	8,000	8,000
2	12,000	20,000
3	15,000	35,000
4	10,000	45,000
5	9,000	54,000

It is evident from the table that the pay back period lies between the third and fourth year. Rs. 35,000 is recovered in three years and Rs. 5,000 is left out of initial investment. So, the pay back period is 3 years plus fraction of a year. This is calculated by dividing the amount required by the cash inflow in the fourth year, i.e.

$$\frac{5,000}{10,000} = .5 \text{ Year}$$

$$\begin{aligned} \text{The pay back period} &= 3 + .5 \\ &= 3.5 \text{ years} \end{aligned}$$

The pay back period can be used as a criterion to accept or reject investment proposals. If the actual pay back period is less than the predetermined period, the project will be accepted. If not it would be rejected.

In case of mutually exclusive projects, the projects are ranked in the order of length of pay back period. The project having the shortest pay back period is ranked as one and the project having the longest pay back period is ranked as the last. Projects with shorter pay back period are selected.

Evaluation

The significant merit of this method is that it is simple to understand and easy to calculate. This method is useful in evaluating the projects whose inflows and life expectancies are uncertain.

The pay back method suffers from the following limitations.

It fails to take into account the cash flows generated after the pay back period.

Illustration 5

	Project A	Project B
Initial investment	20,000	20,000
Cash flows		
Year 1	4,000	6,000
2	7,000	6,000
3	9,000	6,000
4	-	4,000
5	-	3,000
Pay back period	3 Years	3 Years

The above table shows that the pay back period is the same for the two projects. So, both the projects are of equal importance. But, project B generates more cash flows than project A. Naturally, project B is preferable. The pay back method does not consider the total benefits accruing from the project. Therefore, decisions based on pay back period would be misleading.

This method fails to consider the pattern of cash flows i.e. magnitude and timing of cash flows. It gives equal weight to cash flows even though they are received in different periods.

		Project A	Project B
		(Rs.)	(Rs.)
Initial investment		40,000	40,000
Cash flows			
Year	1	10,000	5,000
	2	10,000	8,000
	3	10,000	12,000
	4	10,000	15,000

Table shows that the two projects have the same initial investment, the same total returns and the same pay back period. But project A is preferable because it enables the firm to recover the cash earlier which can be used to repay loan or make investment.

The pay back period does not take into account the earlier life of the project during which cash flows are generated. The projects with large cash flows in the later part of their lives may be rejected. The projects which generate more cash flows in the initial period, but less profitable may be accepted.

Despite the limitations, the pay back period method can be applied in certain circumstances.

- a) The pay back period method is useful to such firms whose primary goal is to get quick return to recover initial investment.

- b) This method can be applied by firms which lay emphasis on short run earning performance rather than its long term growth.
- c) The firms which want to undertake investment in the hope of easing already existing liquidity crisis may make use of the pay back period method as a decision criterion. In this situation, the emphasis is on quick recovery of initial investment.

2) Average rate of return (ARR)

The average rate of return is also known as accounting rate of return. This method is based on accounting information. The accounting rate of return is calculated by dividing the average after tax profits by the average investment.

$$ARR = \frac{\text{Average income}}{\text{Average investment}} \times 100$$

The average income is determined by adding up the expected after tax profits for each year of the project life and dividing by the number of years.

The average investment can be calculated by applying any one of the methods.

$$a) \quad \frac{\text{Original Investment}}{2}$$

$$b) \quad \frac{\text{Original Investment} - \text{Scrap Value}}{2}$$

$$c) \quad \frac{\text{Original Investment} + \text{Scrap Value}}{2}$$

$$d) \frac{\text{Original Investment} - \text{Scrap Value}}{2} + \frac{\text{New working capital} + \text{Scrap value}}{2}$$

Illustration 6

A company proposes to invest in a project requiring a capital investment of Rs. 4,00,000. The estimated annual income after depreciation but before tax is as follows.

Year	Amount (Rs.)
1	2,00,000
2	2,00,000
3	1,60,000
4	1,60,000
5	80,000

Taxation is 50% of the net income. Calculate average rate of return.

Solution

Net income after depreciation and tax

Year	Net income
1	1,00,000
2	1,00,000
3	80,000
4	80,000
5	40,000
	<u>4,00,000</u>

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$$\text{Average return} = \frac{4,00,000}{5} = 80,000$$

$$\text{Average investment} = \frac{4,00,000}{2} = 2,00,000$$

$$\begin{aligned} \text{Average rate of return} &= \frac{80,000}{2,00,000} \times 100 \\ &= 40\% \end{aligned}$$

Illustration 7

Calculate the average investment from the following

Cost of machine 12,000

Scrap value 2,000

Working capital 1,500

List of the machine 5 years

$$\begin{aligned} \text{Average investment} &= \frac{12,000 - 2,000}{2} + 1500 + 2000 \\ &= 10,000/2 + 1500 + 2000 \\ &= \text{Rs. 8,500} \end{aligned}$$

Illustration 8

Calculate the average rate of return from the following data.

Cost of machine Rs. 56,125

Working capital Rs. 6,000

Scrap value Rs. 3,000

Estimated income after depreciation and tax

Year	Income
1	11,000
2	9,000
3	7,000
4	5,000
5	3,000
	35,000

Life of the machine 5 years

Solution

$$\text{Average income} = \frac{35,000}{5}$$

$$\begin{aligned} \text{Average investment} &= \frac{56,125 - 3,000}{2} + 6,000 + 3,000 \\ &= 36,562.50 \end{aligned}$$

$$\begin{aligned} \text{Average rate of return} &= \frac{7,000}{36,562.50} \times 100 \\ &= 19.15 \% \end{aligned}$$

Accept reject criterion

The average rate of return can be used in taking financial decisions. Normally the companies fix a minimum rate of return or cut-off rate. If the average rate of return is higher than the minimum rate, the project is accepted, if not, rejected.

In case of alternative proposals, the proposals are ranked in the descending order of average rate of return. The projects with higher average rate of return are preferred and those with lesser returns are rejected.

Evaluation

Merits

This method is simple to understand and use

The total benefits associated with the proposals are taken into account.

No adjustment is required to arrive at net return. Other methods such as internal rate of return and net present value involve many adjustments and tedious calculations.

Limitations

This method uses accounting profits which are based on arbitrary assumptions. So, it is not appropriate method to evaluate the acceptability of proposals.

It does not take into account the time value of money.

No consideration is given to the size of investment required for each project. Competing projects may have the same average rate of return. As such no decision can be taken by the firm.

For the above reasons, the average rate of return is not a desirable method.

Discounted cash flow Method

The discounted cash flow methods take into account both time

value of money and benefits occurring during the entire life of the projects. It provides a more objective basis for taking investment decisions.

The essential features of discounted cash flow methods are :

- a) Calculation of cash inflows and outflows.
- b) Discounting the cashflows by a discount factor.
- c) Comparing the total of discounted cash inflows and cash outflows.

a) Net present value method (NPV)

NPV method involves the following steps.

- a) Cash inflows and cash outflows associated with the project are calculated.
- b) An appropriate rate of interest should be selected to discount the cashflows.
- c) The present value of cashflows are calculated at the predetermined rate.
- d) The net present value is found out by subtracting the initial cash outlay from the present value of cash inflows.

NPV is defined as the summation of the present values of cash proceeds in each year minus the summation of present value of the net cash outflows in each year.

The equation of calculating NPV is as follows.

Conventional cash flows.

$$NPV = \frac{CF_1}{(1+k)^1} + \frac{CF_2}{(1+k)^2} + \dots + \frac{CF_n}{(1+k)^n} - C$$

Non-conventional cash inflows

$$NPV = \left[\frac{CF_1}{(1+k)^1} + \frac{CF_2}{(1+k)^2} + \dots + \frac{CF_n}{(1+k)^n} - C \right] - \left[C_0 \frac{CF_1}{(1+k)^1} + \frac{CF_2}{(1+k)^2} + \dots + \frac{CF_n}{(1+k)^n} \right]$$

C = cash out flows ; CF = cash inflows ; k = cut off rate

Accept reject criterion

The firm should accept the project if NPV is positive i.e. the present value of cash inflows is more than the present value of cash outflows. If the NPV is negative, the project should be rejected.

Illustration 9

A company is considering an investment proposal involving Rs. 50,000. The machine has a life of 5 years. The company's tax rate is 55%. The firm uses straight line method of depreciation. The estimated cash flows before tax from the investment proposal are as follows.

Year	Cashflows
1	10,000
2	11,000
3	14,000
4	15,000
5	25,000

Calculate NPV at 10% discount rate.

Solution**Determination of cash flows after taxes**

Year	Cash flow before taxes	Depreciation (Rs)	Net profit before tax	Taxes	Net profit after tax	Cash flow after taxes
1	10,000	10,000	-	-	-	10,000
2	11,000	10,000	1,000	550	450	10,450
3	14,000	10,000	4,000	2,200	1,800	11,800
4	15,000	10,000	5,000	2,750	2,250	12,250
5	25,000	10,000	15,000	8,250	6,750	16,750
		<u>50,000</u>			<u>11,250</u>	<u>61,250</u>

Net present value

Year	Cash flow after taxes (Rs)	Pv factor at 10%	Present value (Rs.)
1	10,000	0.909	9090
2	10,450	0.826	8632
3	11,800	0.751	8862
4	12,250	0.683	8367
5	16,750	0.621	10,401

Total net present value **45,352**

Less

Present value of cash out flow **50,000**

Net present value **- 4,648**

Evaluation

Merits

NPV method recognizes the time value of money.

It considers total benefits arising out of investment proposal.

This method is useful in evaluating mutually exclusive projects.

It is consistent with the objective of maximising share holders wealth.

Limitations

It is difficult to calculate unlike pay back period or average rate of return.

The discount rate is the significant element in calculating the present values. Use of different rates will give different values. The change in discount rate will change the desirability of the project.

This method is useful when a comparison is to be made between two projects. In case of projects involving different outlays this method may not be an appropriate one.

b) Present value index method

In this method, the present value index is found out by comparing the total present value of cash inflows and total present value of cash out flows.

$$\text{Present value index} = \frac{\text{Present value of inflow}}{\text{Present value of outflows}} \times 100$$

Illustration 10

The present value of inflows of the machines A and B are Rs. 53,461 and Rs. 56,819 respectively. The present cash outflow is Rs. 50,000. Calculate the present value index.

Present value index

$$\text{Machine A} = \frac{53,461}{50,000} \times 100$$

$$107 \%$$

$$\text{Machine B} = \frac{56,819}{50,000} \times 100$$

$$= 113.6\%$$

c) Internal rate of return (IRR)

The internal rate of return is usually the rate of return that a project earns. It is the rate which equates the present value of cash inflows with the present value of cash out flows of an investment. In other words, it is the rate at which the net present value of an investment is zero. It can be stated in the form of a ratio as follows.

$$\frac{\text{Cash inflows}}{\text{Cash outflows}} = 1$$

In this method, the cash flows are known but discount rate is not known. For instance, a sum of Rs. 1000 is invested in a project which becomes Rs. 1200 at the end of the year. The rate of return will be

$$C = \frac{C}{1+r}$$

C = Initial investment

CF = Cash inflows

r = Rate of return

$$1000 = \frac{1200}{1+r}$$

$$\text{or } 1000 + 1000r = 1200$$

$$\text{or } 1000r = 1200 - 1000$$

$$= \frac{200}{1000} = .2$$

$$= 20\%$$

The equation for calculating IRR is as follows

For conventional cash flows

$$IRR = \frac{CF_1}{(1+K)^1} + \frac{CF_2}{(1+K)^2} + \dots + \frac{CF_n}{(1+K)^n} - C$$

Non-conventional cash inflows

$$IRR = \left[\frac{CF_1}{(1+K)^1} + \frac{CF_2}{(1+K)^2} + \dots + \frac{CF_n}{(1+K)^n} - C \right] - \left[C \frac{CF_1}{(1+K)^1} + \frac{CF_2}{(1+K)^2} + \dots + \frac{CF_n}{(1+K)^n} \right]$$

r = Internal rate of return

CF = Cash inflows

C = Cash outflow

Accept reject decision

The IRR is compared with the required rate of return or the cut off rate to take a decision. If the IRR exceeds the cut off rate, the project would be accepted. If not, rejected.

Computation of IRR

Cash flows are uniform

In case of projects which generate uniform cash flows, the IRR is calculated first by finding out the factor.

The factor is calculated as follows.

$$F = \frac{I}{C}$$

I = Original investment

C = Cash flow per year

The factor, so calculated is located in annuity table (Present value of Re. 1 Received annually for N years).

Illustration 11

A machine costs Rs. 9,000 and it is expected to generate annual cash flow of Rs. 3000 for five years.

Calculate the internal rate of return.

$$F = \frac{I}{C}$$

$$F = \frac{9000}{3000} = 3$$

The factor three is to be located in the PV table in the line of 5 years. The discount rate would be between 18% (3.127) and 20% (2.991). It denotes that IRR is more than 18% but less than 20%. But on interpolation, the exact rate can be calculated. In this case Rs. 2.991 is very near to 3 and so the IRR can be taken as 20%.

Cash flows are not uniform

When cash flows are not uniform, IRR is calculated by trial and error. In order to equate the present value of cash inflows with the present value of cash outflows, the cash inflows are discounted by a number of trial rates. The following illustration explains the points clearly

Illustration 12

The estimated cash flows from the proposed investment proposal is as follows.

The cost of project is Rs. 50,000

Cash inflows

Year	Amount
1	10,000
2	10,450
3	11,800
4	12,250
5	16,750

Calculate the internal rate of return.

Solution

In the above problem, cash flows are not uniform. So, the IRR is to be calculated by trial and error method.

First, find out the factor

$$\text{Factor} = \frac{I}{R}$$

$$= \frac{\text{investment}}{\text{Average cash flow per year}}$$

$$= \frac{50,000}{12,250}$$

The factor 4.08 helps us in selecting the discount rate for initial trial. We should look to present value table. In the five year row, find a figure close to 4.08. The discount factor appears to be near 7%/. Since the actual cash flow in the initial years is less than the average cash flows, the IRR is likely to be lower than 7%. The IRR is more than 6% and less than 7%.

Year	Cash flows	Discount factor 6%	Total Pv	Discount factor 7%	Total Pv
1	10,000	0.943	9,430	0.935	9,350
2	10,450	0.890	9,300	0.873	9,123
3	11,800	0.840	9,912	0.816	9,629
4	12,250	0.792	9,702	0.763	9,347
5	16,750	0.747	12,512	0.713	11,942
			<u>50,856</u>		<u>49,391</u>

215

Less Initial outlay	50,000	50,000
	856	-609

The NPV is +856 at 6% and -609 at 7%. The exact rate may be calculated as follows.

$$\begin{aligned}
 \text{IRR} &= 6 + \frac{\text{Calculated present value} - \text{required cash outlay}}{\text{Difference in calculated present value}} \\
 &= 6 + \frac{50,856 - 50,000}{50,856 - 49,391} \\
 &= 6 + \frac{856}{1465} \\
 &= 6 + 0.59 \\
 &= 6.59 \%
 \end{aligned}$$

Evaluation

Merits

It is easy to understand

It considers time value of money and takes into account total cash flows

It provides a rate of return which indicates profitability of the proposal.

Limitations

This method involves tedious calculations

It fails to indicate a correct choice between mutually exclusive projects under certain condition.

The IRR method assumes reinvestment at the IRR. But the same firm has no ability to invest cash flows at different rates. Moreover, the assumption that cash flows will be reinvested is not correct.

NPV - IRR methods

Similarities and differences

The two methods would give the same result in terms of acceptance or rejection of an investment proposal in respect of conventional and independent projects. A conventional project is one in which cash outflows are confined to the initial period. It is followed by cash out flows. Independent proposals refer to investment the acceptance of which does not preclude the acceptance of others.

In mutually exclusive projects, the NPV and IRR methods can give conflicting may arise due to one or more of the following reasons.

- a) The cash flow patterns of the project may differ
- b) The projects may require different cash outlay
- c) The projects may have unequal lives

The IRR method is concerned with the rate of return on investment. NPV method considers the total yield on investment. Since the objective of the firm is wealth maximation, the result given by the NPV method should be relied upon.

Capital rationing

Capital rationing refers to a situation where the firm is constrained to obtain necessary funds to invest in all investment projects with positive NPV. The constraints which lead to a decision to hold

capital expenditure to a fixed sum may arise due to market conditions or may be entirely self imposed.

Under capital rationing, the management has to decide not the profitable investment proposal but to obtain the combination of the proposals which yields the highest rate of return and profitability indices.

Illustration 13

A firm has the following investment opportunities

Projects	Cash Outlay	NPV at 10%	Profitability index
1	50,000	12.94	26
2	25,000	8.12	1.32
3	25,000	7.75	1.31

Which proposals the firm should accept?

If the firm has no financial constraint, it can undertake all the three projects because NPV is positive in all the projects. Suppose the firm has a constraint, say Rs. 50,000 only. If it goes by NPV rule it will accept project 1. But projects 2 and 3 together have higher NPV (15.87) than project 1. The investment of the two projects are within the financial resources available. The projects which give the highest ratio (present value initial outlay) should be accepted.

Analysis of risk and uncertainty

The various techniques, so far, studies for evaluated investment proposals are based on the assumption that the proposals are based on the assumption that the proposals do not involve any kind of risk. In

fact, profitability and risk are closely related. A potentially profitable project may have perceived risk. The acceptance of such project may make the firm risky. This may have adverse effect on the market price of shares and total valuation of the firm. Hence risk dimension in capital budgeting is important.

Risk-defined

The term risk with reference to investment decision may be defined as the variability in the actual returns emanating from a project in future over its working life in relation to the estimated return as forecast at the time of the initial capital budgeting decision'. In brief, risk results from variation between the estimated and actual returns.

Incorporation of risk

The following are the techniques used to incorporate risk factor in capital budgeting decision.

- a) Sensitivity analysis
- b) Profitability assignment
- c) Standard deviation
- d) Coefficient of variation
- e) Risk adjusted discount rate
- f) Certainty equivalence
- g) Decision tree

Sensitivity analysis

Sensitivity analysis involves using a number of possible outcomes in calculating a project. Usually it provides information about cash flows under three assumptions i) Pessimistic (the worst) ii) Most likely (the expected) and iii) Optimistic (the best). The larger is the difference between the pessimistic and optimistic cash flows, the more risky is the project and vice versa.

Illustration 14

A company wants to evaluate two mutually exclusive projects X and Y, each requiring an investment of Rs. 10,000. The most likely annual cash inflows of the two projects is Rs. 2000 for the next 15 years. The firm's cost of capital is 10%. The company has made pessimistic and optimistic estimates of annual cash flows for each project as follows.

	Project X	Project Y
	Rs.	Rs.
Pessimistic	1500	-
Most likely	2000	2000
Optimistic	2500	4000

Suggest the management to arrive at a decision.

Solution

Project X			Project Y		
Cash flows	PV	NPV	Cash flows	PV	NPV
1500	11409	1409	-	-	-10000
2000	15212	5212	2000	15212	5212
2500	19015	9015	4000	30424	20424

Note

Discount factor at 10% is 7.606

The above table indicates that project X is less risky than project Y. However, the final decision depends on the attitude of the decision maker.

Sensitivity analysis is a crude method. But, it provides decision maker with more than one estimate of a project's outcome.

Review Questions

- 1) Explain the three types of sources of finance.
- 2) What is the role of commercial banks in Entrepreneurial Development.
- 3) List the elements that are to be included in the application for financial assistance.
- 4) What is capital budgeting ? Discuss the importance of capital budgeting ?
- 5) What are the various types of capital budgeting decisions ?

UNIT - IV

TECHNOLOGICAL ENVIRONMENT

Among all the segments of macro environment, technological environment exerts considerable influence on business. This section is devoted to a detailed discussion of the interlace between business and technology.

J.K.Galbraith defines technology as a systematic application of scientific or other organised knowledge to practical tasks. During the last 150 years, technology has developed beyond anybody's comprehension. Since and technology (see Box 7.1 for the differences between the two terms) enable man to conquer distances, control birth rate, save lives, generate, preserve and distribute energy, discover new materials, and substitutes to existing ones, introduce machines to do the work of human beings, substitute mental work with computers, probe deep into the seas and space in search of new treasure, provide himself with lot of leisure and comfort.

As years roll by, new discoveries have been added. 1983 was particularly considered by scientists as the year of scientific success. In this year scientists put a billion dollar technology into space, produced the world's first test-tube triplets and obtained evidence of another solar system. In the field of medicine, Japan marketed the much-awaited artificial blood system. A major break through was achieved in the field of genetic engineering to cure dwarfism. The U.S. Physicists stripped off all the electrons from the uranium atom

thus exposing the bare nucleus. It was also the year when the doctors, were confronted with a baffling disease, viz. AIDS (Acquired Immune Deficiency Syndrome) also named 'Grade Plague' that has taken a heavy toll of human lives.

Technology is the most dramatic force shaping the destiny of people all over the world. Some of the technological inventions, the man feels, are wonders, some others are horrors, and yet others have mixed blessings. Automobiles and television. For example, have evoked mixed reactions. Hydrogen bomb, nerve gas and submarine gun have proved to be horrors. Penicillin, open heart surgery and birth control pills are wonders.

Whether one is enthralled or appalled by a technological invention depends on one's attitude towards it.

Technology and Business

The interface between business and technology is explained in the following paragraphs. (See Fig. 4.1)

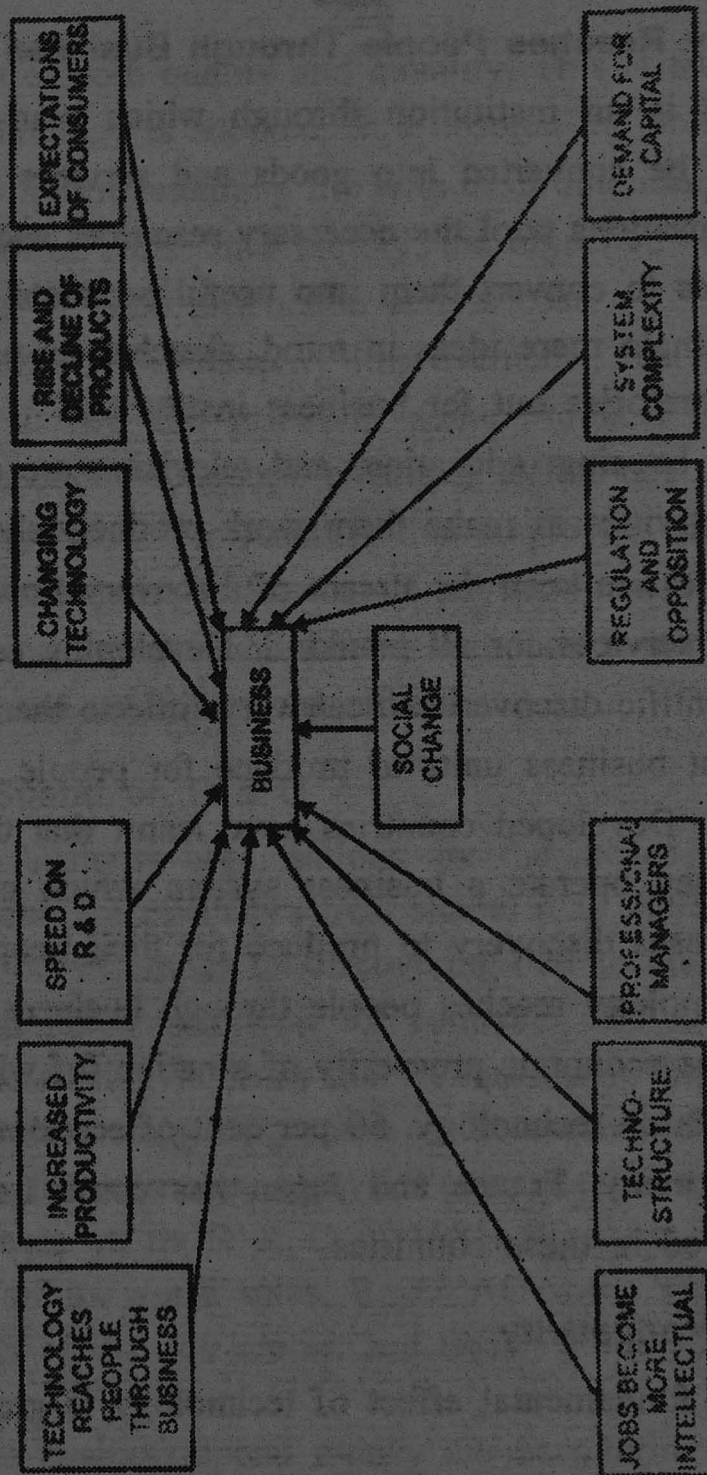


Fig. 4.1 Interference between Business and Technology

1. Technology Reaches People Through Business

Business is an institution through which man expects new discoveries to be converted into goods and services. Managers of business organisations pool the necessary resources and work on the new discoveries to convert them into useful products. New discoveries would remain mere ideas in mind, sketches on paper or mock models in laboratories but for business institutions.

Printing, housing, education, and television are all dependent on business activities to make them work productively. Society depends on business to keep the stream of discovery flowing into useful goods and services for all mankind. Developing countries have learnt that scientific discoveries mean very little to them unless they have competent business units to produce for people what science has discovered. Developed countries have learnt that their progress stops unless they operate a business system which contributes to discovery and uses discovery to produce for their people.

That technology reaches people through business is only part of the story. The economic prosperity of a nation (of which business is part) depends on technology. 50 per cent of economic growth of USA, UK, Germany, France and Japan has come from technical progress achieved in these countries.

2. Increased Productivity

The most fundamental effect of technology is greater produc-

tivity in terms of both quality and quantity. This is the main reason why most technology is adopted. In a hospital the objective may be qualitative, such as maintaining life with electronic monitoring equipment regardless of costs. In a factory, the objective may be quantitative in terms of more production at less cost.

As a result of productivity improvements, real wages of employees tend to rise and prices of some products decline, which spreads the beneficial economic effects of technology throughout the whole social systems. The result is that employees and citizens are motivated to want more technological advancement, thereby placing on major business responsibilities to introduce it with due concern for its social and environmental effects.

3. Need to Spend on R & D

Though business organisations are the means through which new innovations are given practical shape, it is the business which has to spend lots of money on discovering new technology. Business should not sit pretty and wait for someone else to discover new ideas. It is heartening to learn that companies in industrialised nations are spending staggering sums on Research and Development.

Phillips, for examples, spent 6.9 percent of its total turnover of Rs. 1,300 crores on its R & D in 1981. Similarly, Seimens spent nine percent of its world sales, Bayer AG spent six percent of its domestic sales of Rs. 280 crores, and Bosch group spent 6.7 percent of its sales.

Why do business spend money on discovering new technolo-

gies ? At least four reasons are responsible to investing a) declining growth in base business, b) dramatic development in new technologies, c) development of international competition, and d) vitality of the venture markets (see Fig. 4.2).

As seen in Fig 4.2 While many companies start investing money on new technologies, several questions start nagging them. This is lack of confidence in the "what", "where" and "how" What technologies will provide opportunities ? Where will these opportunities be ? and How do we go about pursuing them ?

4. Fast Changing Technology

Enormous spending on R. & D by governments and private industries all over the world has resulted in the fast development

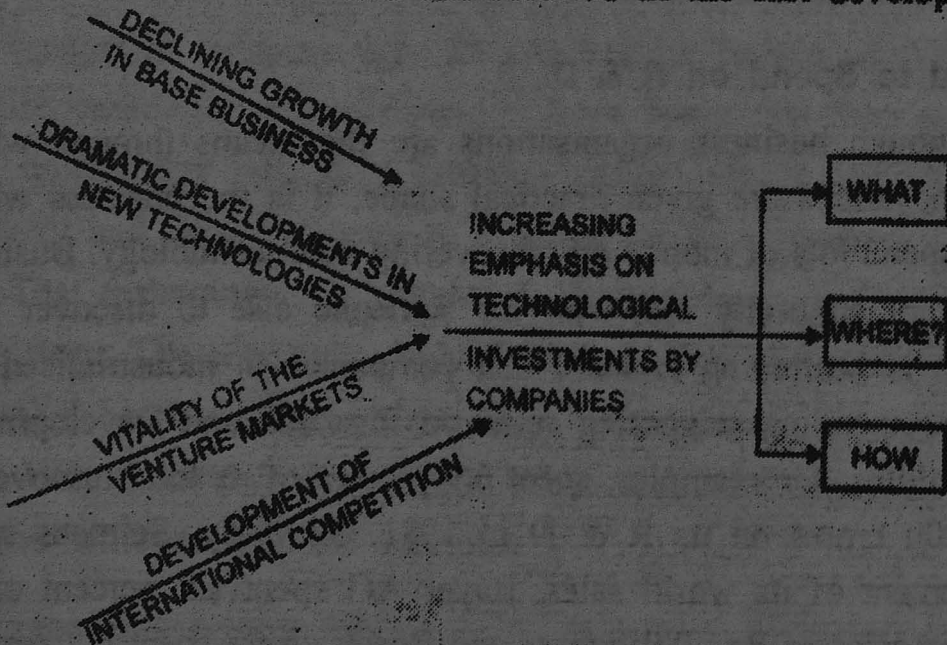


Fig 4.2 Forces Leading to Increasing Technology Investment

(Source: R.B.Lamb, "Competitive Strategic Management", p 506)

and change in technology. Many of today's common products were not available even one hundred years ago. Abraham Lincoln did not know of automobiles, airplanes, phonographs, radios or the electric light. Woodrow Wilson did not know of television, aerosol cans, home freezers, automatic dishwashers, room air-conditioned, antibiotics, or electronic computers. Franklin Delano Roosevelt did not know xerography, synthetic detergents, tape recorders, birth control pills, or earth satellites. And John Kennedy did not know of personal computers, digital wristwatches, video recorders or word processors or synthetic fibers.

More ideas are being worked on the time gap between idea and implementation is falling rapidly, and the time between introduction and peak production is shortening considerably. Experts have estimated that 80 to 90 percent of all the scientists who ever lived are still today. Business units and their managers must always watch out for changes and developments taking place around. New developments must be adopted and new ideas explored lest the business units would expire early.

Meanwhile, technology change generally proceeds on the following levels.

- 1) Fundamentals of basic research stage. In this level, scientific discovery of a new physical phenomenon or a new theoretical concept occurs.
- 2) Applied research further crystallizes the true nature of the knowledge and demonstrates its potential utility through

the use of bench scale approaches.

- 3) Development reduces this knowledge to practice in workable prototype form.
- 4) Engineering refines the knowledge for commercial exploitation or other practical end uses.
- 5) Operations such as manufacturing finally puts the technology to use, and it becomes adopted and used by others.

The demarcation lines between these levels is often hazy, nevertheless, a different level of technical skills and business orientation is needed for each. Hence these levels are normally preformed by different groups of individuals in a society and often within companies.

The first two stages embrace what is known as "invention".

The third and the fourth stages constitute what is typically labelled "innovation". And the fifth stage is "diffusion", the time required for the technology to become accepted in general use.

At each of technological change, there are barriers which come in the way of introduction of new technology. The barriers include (a) problems with the new technologies themselves, (b) inappropriate/inadequate systems for capital allocations, (c) limitations of the vendors of the new technology, (d) personnel and labour problems in perceiving the new technology (e) internal resistance and risk aversion on the part of production managers and (f) lack of manufacturing strategy.

5. Rise and Decline of Products and Organisations

Change of technology, therefore, is a norm and not an exception. This poses another problem to business. A new technology may spawn a major industry but it may also destroy an existing one. Transistors, for example, hurt the vacuum-tube industry and zerography hurt the carbon-paper business. Television hurt radios and movies and synthetic fibers reduced demand for cotton fabrics. It is for this reason that Schumpeter saw technology as a force for 'creative destruction'. And it is precisely for the same reason that the saying, "Today's growth product is tomorrow's earthen pot", becomes relevant. Products, like morals, have life cycles. A typical product, today, is subject to a cycle introduction, growth, maturity, decline, and abandonment.

An organisation that is associated with a particular technology is influenced by it and will have the same life pattern as of the technology. Such an organisation will go in sequence through the introductory, growth, maturity, and decline phases. The life of such an organisation may be composed of the following stages. (i) birth, (ii) growth (iii) policy (iv) procedure, (v) theory (vi) religion (vii) ritual and (viii) last rites. In this eight-step sequence, an organisation is born and then has its growth. Policies are developed to guide decisions, and these are carried out through procedures. These procedures are refined and made more efficient with theories about efficiency. In time the organisation may develop characteristics of a religion, it may worship the way it does things. Performance is by

ritual, things are done by habit without questioning. The death and last rites of the organisation will ordinarily follow.

6. High Expectations of Consumers

That the business should keep changing is reinforced by yet another fact, a fact which is the cause and consequence of technology. Technology has contributed to the emergence of affluent societies. Affluent citizens want more of many things than more of same things. New varieties of products, superior in quality free from pollution, more safe and more comfortable, are to be produced and supplied to the affluent sections. This calls for a massive investment in R & D. One important compulsion for investing in technological advances in Japan is its customer's high expectations regarding design sophistication, quality, delivery schedule and prices. Industry-owners in Japan swear by the dictum-the customer is a god who is always right. High expectations of consumers pose a challenge and an opportunity to the owners of business institutions.

7. Job Tend to Become More Intellectual

With the advent of technology, jobs tend to become more intellectual or upgraded. A job hitherto handled by an illiterate and unskilled worker now requires the services of an educated and competent worker. A clerical post in an office now demands the services of an expert in computers. Fig. 4.3 demonstrates the change in the type of labour now required to work on machines.

Decades ago, the typical factory had a range of skills resembling curve A. This curve was shaped like the normal curve

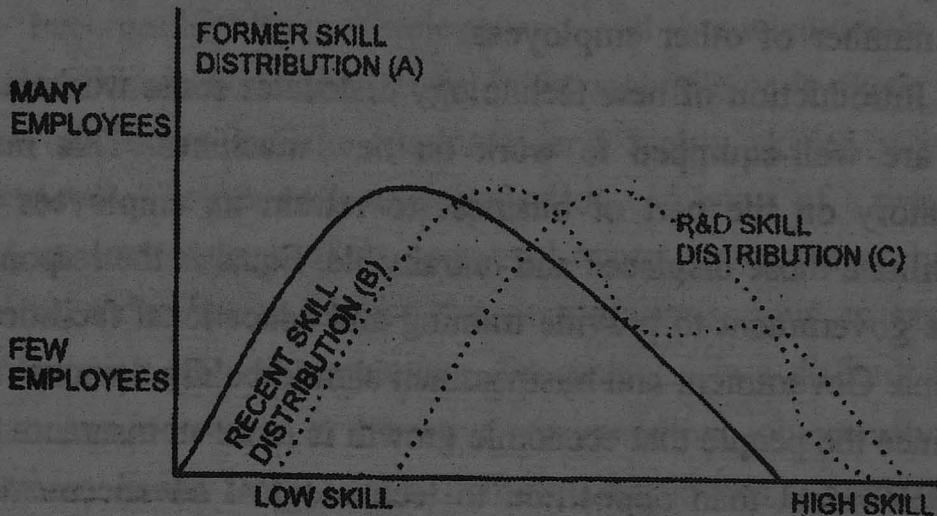


Fig 4.3 Change in Skill, Distribution in a Business Required by Advances in Technology.

of intelligence among people. Being matched to people, it suggested that an adequate supply of labour would be available at all levels of business in the long-run. "In modern business". Stress Davis, "the curve has moved towards the right, higher in skill as shown in curve B. And in many organisations the skill distribution has become bi-model, as shown by the second top on the curve. Many scientific and professional people are required in research, development, planning and other specialised work, creating the secondary bulge towards the skills end of the scale."

Curve C represents the skill distribution which is developing in firms oriented towards research and development. Though these firms manufacture products for sale, much of their effort is devoted to

development and building prototypes. In some of these, the number of engineers, scientists, college graduates and specialists exceed the total number of other employees.

Introduction of new technology dislocates some workers unless they are well-equipped to work on new machines. This makes it obligatory on the part of business to retrain its employees and to rehabilitate those displaced and untrainable. Equal is the responsibility of the government to provide training and educational facilities to its citizens. Government and businessmen should boldly demonstrate and convince the people that economic growth is more an insurance against unemployment than opposition to technological advancement.

But for those who pick up and acquaint themselves with new technology, the job will be rewarding. The new job will be more challenging and rewarding. Working class, in general stands to gain through increases in productivity, reduced prices and increased real wages-all by products of technological advancement.

Along with upgrading jobs, technology has its impact on human relations. Technology lays down the requirements for much of the human interaction in organisations. The arrangement of a production set-up determines who will be near whom. The work flow determines who needs to talk to whom. And since interaction and activity affect sentiments, technology indirectly determines what individuals in large groups will feel and think about one another and about their work situation.

8. Problem of Technostructure

Not only jobs become more intellectual, even the incumbents tend to become highly professionalised and knowledgeable. An organisation which has adopted the latest technology is flush with scientists, engineers, college graduates and highly skilled workers on its pay roll. Though such an organisation can boast of a progressive and modern outlook of its personnel complement, the problems such an enterprise has to face on this account are serious, to say the least. Motivation of such employees, for instance, is a difficult task. Such mundane incentives as attractive remuneration, job security and just treatment, hardly inspire the enlightened employees to work more. They are instead motivated by opportunities which offer challenge or growth and achievement. Secondly, retaining such employees for long is difficult job. Being cosmopolitan in their outlook, these professionalised employees are known for organisational rootlessness and job-hopping. Flighting and not sticking is their culture. The company has to make several exceptions to discourage rootlessness of its professionalised employees. Regular attendance and punctuality have to be relaxed dual promotion ladders have to be established so that distinguished technical people can rise in rank, profit-sharing to be provided to give creative persons a financial stake in the ideas they create, attendance at professional get-togethers has to be sponsored writing professional articles has to be encouraged, and special assignments and part-time teaching may be allowed. Thirdly scientific and professional workers constitute what Galbraith calls the techno-

structure of a modern organisation. The technostructure tries to control the organisation through influencing management's decision making. While there may be nothing wrong in making decisions prompted by the technostructure, the problem lies in the social effect that is involved. People constituting technostructure are experts, no doubt. But they are more action-oriented and are yet to learn social problems of business decisions. Management is therefore, in a right position to balance the ruffled feelings of technocrats and the social consequences of business decisions.

The presence of technicians is not confined to the precincts of an industrial establishment, the influence goes beyond and covers the entire gamut of society. The social values change to productivity, rationality and efficiency when society gets dominated by technicians. Social institutions may be reconstructed or even eliminated. Family, for instance, might prove an anachronism as family loyalties might well interfere with rationality and efficiency. Procreative functions might be according to the laws of eugenics, breaking the age-old barriers of inbreeding. Education could be made a purely pragmatic institution, devoted to scientific and technical disciplines. Most significant is the fact that scientist and technicians are and will continue to be the keymen in our civilisation.

9. Need for Bioprofessional and Multiprofessional Managers

Technocrats, who assume reins of administrations, need to be qualified in management education in addition to the proficiency

they have acquired in chosen fields of specialisation. Today's business needs biprofessional and multiprofessional managers. To fill up a factory manager's post, for instance, the desired qualification stipulated is a degree in engineering and M.B.A. from a recognised institution. The need for managers well-versed in different fields of knowledge is greatly felt now than ever before. Technological advancement has made the business more complex and its management more demanding.

Business and government must, therefore, spend more and more on spreading knowledge on know-how (technology) and do-how (management). Such a task is expensive but technology's greater productivity eases the burden of costly education and the training it requires.

10. Increased Regulation and Stiff Opposition

A by-product of technological advancement is the ever-increasing regulation imposed on business by the government of the land and stiff opposition from the public. Government has the power to investigate and ban products that are directly harmful or hurt the sentiments of a section of society. Import of animal tallow has been banned by the Government of India because the alleged mixture of tallow with vanaspati oil hurt the feelings of Hindus. continuous struggle launched by the FMRAI (Federation of Medical Representatives of India) produced gainful results like banning of the sale of harmful drugs and banning of sales promotion and advertisement of infant formula through the mass media.

Technological advancement is inviting

opposition from those who fear that new innovations are a threat to ecology, privacy, simplicity and even the human race. These people oppose construction of high-rise buildings, location of plants that eject harmful effluent, and setting up of hydroelectric plants. As the production process becomes more complex and products assume greater sophistication, public have to be assured of their (products) safety, their minimal propensity to cause pollution, and their least threat to happiness and well-being of the human race.

The public must be enlightened that technology is not always unidirectional in its effects. It can be corrective as well as curative. Technology has created antibiotics which give rise to side effects. The same technology has also shown remedial measures for the side effects. Again, technology causes pollution, but it can also be used to check pollution caused by it and by human beings. Technology does contribute to urban blight, but it can also be used to beautify the city and make it more comfortable and enjoyable for the people to live in.

11. System Complexity

Technology has resulted in complexity. Modern machines work better and faster, no doubt. But if they fail, they need services of experts to repair. They fail often because of their complexity. A machine or a system is composed of several hundred components. All parts must work in tandem to accomplish a desired task. Reliable

performance of each part, therefore, assumes greater significance.

Also there is interdependence of systems. Failure of power supply, for example, will cause dry water taps, closed patrol bunks, suspended elevators between floors, dark streets, dark house, dead TVs, closed retail establishments and so on. A localised problem in a power house balloons into a regional problem affecting thousands of people. It is possible that technology might eventually lead to simplicity and small independent operational units. Such a possibility still remains a distant dream. Mean while, more complexity in work and product systems is expected. Management is, therefore, under pressure to keep the whole system working all the time.

12. Insatiable Demand for Capital.

Today's technology necessitates massive investment of money on acquiring or discovering of new ideas and their adoption, educating training and maintaining of the managers and the managed and on several other related areas. In fact, today's technology is characterised by its insatiable demand for capital. Business organisations should not only raise huge funds, exploiting all ways and means, the mobilised funds must be judiciously employed for gainful purposes. This calls for honest and efficient financial management. Qualified and competent people must be appointed to assume responsibility for financial management and should be given due place in the hierarchy of organisation.

13. Social Change

Perhaps the most striking influence of technology is found on society. Practically every area of social life and the life of every individual has been in some sense changed by the development in technology. However, two major modes of technological influence on social life may be noticed. Firstly, there is the change in social life which results from a change in a technological process. Thus, an invention may destroy the economic basis of a city, displace thousands of workers, yet the same invention may result in the creation of a new city somewhere else and create even more jobs than it originally destroyed. Technological changes of this sort create a constant turmoil in society, with socially uprooted, mobile populations drifting about in search of new centres of employment. Sometimes, this drifting may result in a new geographical distribution of population. An example is provided by the constant drift of population centres of electronic or aerospace industries.

Besides uprooting population technology directly changes the patterns of their social life, for instance the family, the sensitive recorder of all types of change, alters with technological development. An invention may open new employment opportunities to women, radically change hours spent at work and in the family increase available leisure time, open jobs to youth, and deny them to middle aged or old workers. Technological development may basically change the stratification system of a community. Skilled jobs, carrying great prestige, may be destroyed. Jobs may be opened to

members of discriminated against and low-ranking or racial groups. Technological advancement tends to smooth out social differences. Industrial technology tends to iron out differences between sexes and between parents and children in a family.

Though social differences tend to be ironed out, status differences are likely to be created by technological advancement in developing countries. Technology flows to less developed countries mainly through multinational companies. With vast resources at their command, multinational corporations (MNCs) have carved out places and images for themselves distinct from local companies. Along with the MNCs people associated with them directly or indirectly behave like a class apart by themselves. Such people are better paid than their counterparts in local companies. With higher incomes, the standard of living enjoyed by these people is fairly high. They form exclusive clubs and are culturally more at home with the industrial West. In fact, the cultural integration of these neo-rich people with the industrial West is so complete that they read the same books, see the same films and TV programmes, have similar fashions, similar groups or organisations of family and social life, similar styles of decorating the home, similar housing, building furniture and urban designs. Despite linguistic barriers they have a far greater capacity for communication among themselves than is possible between illiterate and managerial persons in the same country speaking the same language. This international community, which has similar patterns of consumption, must have similar patterns of income as well. In

India, the employees in foreign collaborations are paid much more than they are paid in other local Indian companies, though they do the same job in the same field.

14. Others

Thus, implications of technology on business are several. Some more can also be added.

It may be stated that technological change can affect the whole industries in three ways, it can rejuvenate an industry, obsolete existing industries, or bring into being totally new industries. For example, the watch industry has been dramatically rejuvenated by the evolution through mechanical, electronic, and digital technologies. The advent of personal computers as a potent substitute for personal calculators has rendered the latter almost obsolete.

* Technological change is a potent force in the reconfiguring of industry boundaries, it may broaden or narrow generally accepted industry boundaries. For example, advances in information technologies have rendered old conception of the financial services industry obsolete, insurance firms, banks, and brokerage houses can now all be interconnected to provide new financial services, thus blurring long-held distinctions among the services offered by these industries.

* As a consequence of its impact on whole industries, technological change can have a significant impact on the prevailing business definition of individual companies. Companies may find

themselves in a different business due to technological changes that they or others have effected. For example, Xerox (in the U.S) landed itself in such position in its copier business thanks to the success of Japanese firms in miniaturising products. Because Japanese firms introduced smaller-sized copiers, Xerox found itself selling to different customers with different needs through different distribution channels and competing for different bases (price was much more important).

* Technological change is one of the important factors giving rise to product substitution and product differentiation. For example, plastics have replaced many uses of steel, and microwave ovens are now frequently substituted for conventional ovens. Similarly in videotape recorders, companies have sought to differentiate their products through the introduction of technologically based features, longer recording time, longer recording time setting, sharper picture reproduction, clearer sound, and so on.

The above examples suggest that technological change is a dominant force in shaping competitive dynamics in many industries. It influences industry boundaries and structure product substitution and differentiation, and the price and quality relationships between products.

* Technological change in the form of process (as opposed to product) and materials innovations may contribute to many of the impact noted above. For example, process innovations such as automation, robotics, and CAD/CAM have bestowed cost and quality

advantages on many companies. Japanese automobile manufacturers have gained a significant competitive edge on their rivals elsewhere through the adroit use of this form of technological change.

* Finally for multiproduct companies (preceding discussion applies to single-business units) technological change may have multiple impacts. For example, technological change can create new synergies across businesses or obsolete existing ones. Advances in telecommunications and computer technologies have made new synergies possible across business dealing with computers, television sets, and communications.

STATUS OF TECHNOLOGY IN INDIA

India, like any other third world country, attended political independence after prolonged colonial rule and exploitation. The country entered the modern world in a state of economic backwardness and poverty of a large section of people. It is obvious that technology must attend to the basic problems of food, clothing, health and housing of people. At the same time rapid industrial development through latest technology is necessary to catch up with the advanced countries.

With these objectives in mind, Government of India set-up series of R & D establishments, space research centres, medical research centres, agricultural research establishments, oil exploration centres, power development projects, and the Council of Scientific and Industrial Research. Besides, several universities and institutes have been

set-up to provide higher education in science technology and management. As on today there are 4700 intermediate/junior colleges, 144 universities, and 44 deemed universities in the country. Also there are more than 500 science and technological institutions, and 1080 in-house research and development laboratories. There is also the Department of Science and Technology, an administrative wing of the government, to coordinate the activities of all research and technical activities in the country.

The government also came out with a policy on technology spelling out its aims and the thrust areas. The salient features of technological policy are the following.

Technological Policy

Preamble

Frontiers of knowledge are being extended at an incredible speed, opening up wholly new areas and introducing new concepts. Technological advances are influencing life-styles as well as social expectations.

India is known for its diversity. Technology must suit local needs and to make an impact on the lives of ordinary citizens, must give constant thought to even small improvements which could make better and more cost effective use of existing materials and methods of work.

Aims : The basic objectives of the Technology Policy will be the development of indigenous technology and efficient absorption and adaptation of imported technology appropriate to national priori-

ties and resources. Its aims are to

- a) attain technological competence and self-reliance, to reduce vulnerability, particularly in strategic and critical areas, making the maximum use of indigenous resources.
- b) Provide the maximum gainful and satisfying employment to all strata of society
- c) use traditional skills and capabilities making them commercially competitive.
- d) ensure the correct mix between mass production technologies and production by the masses.
- e) ensure maximum development with minimum capital outlay.
- f) identify obsolescence of technology and arrange for modernisation of both equipment and technology.
- g) develop technologies which are internationally competitive, particularly those with export potential.
- h) improve product speedily through great efficiency and fuller utilisation of existing capabilities, and enhance the quality and reliability of performance and output.
- i) reduce demands on energy, particularly energy from non renewable sources.
- j) ensure harmony with environment, preserve the ecological balance and improve the equality of the habitat and
- k) recycle waste materials and make full utilisation of by products.

Strengthening the Technology Base: Research and development together with science and technology education and training of a high order will be accorded pride of place. Special attention will be given to the promotion and strengthening of the technology base in newly emerging and frontier areas such as information and material sciences, electronics and bio-technology. Education and training to upgrade skills are also of utmost importance. Basic research and the building of centres of excellence will be encouraged.

Skills and skilled worker will be accorded recognition. The quality and efficiency of the technology generation and delivery system will be continuously monitored and upgraded. Technologies relevant to the cottage, village and small industries sector will be upgraded. In all sector, the potential impact on employment will be an important criterion in the choice of technology.

Energy constitutes an expensive and sometimes scare input. Therefore, the energy requirements both of a direct nature for each product and each production activity and the associated technology employed will be analysed. Measures will be devised to avoid wastage to non-optimal use of energy. Necessary fiscal measures will be introduced to ensure these. Research and Development in the energy sector will aim at improving the efficiency of its production, distribution and utilisation, as well as improvement of efficiency in process and equipment.

Technology already employed will be evaluated on a continuing basis to realise maximum benefits in terms of increased production and lower costs, especially in the public enterprises.

Some Specific Areas: In technology development special emphasis will be focussed on food, health, housing, energy and industry. In particular, stress will be laid on.

- * agriculture including dry-land farming.
- * optimum use of water resources, increase production of pulses and oilseeds
- * provisions of drinking water in rural areas, improvement in nutrition, rapid reduction in the incidence of blindness, eradication of major communicable diseases such as leprosy and tuberculosis)
- * low cost housing
- * development and use of renewable non-conventional sources of energy and
- * Industrial development.

Technology Development:

Fullest support will be given to the development of indigenous technology to achieve technological self reliance and reduce the dependence on foreign inputs, particularly in critical and vulnerable areas and high value-added items in which the domestic base is strong. Strengthening and diversifying the domestic technology base are necessary to reduce imports and to expand exports for which international competitiveness must be ensured.

In view of the cost of technology development and the time necessary for successful marketing of a new or improved product,

indigenously developed items are invariably at a disadvantage compared with imported products or those based on imported technologies and brand names. Suitable fiscal mechanisms will be established to facilitate investment on pilot plants, process demonstration units and prototype development in order to enable rapid commercial exploitation of technologies developed in laboratories. Linkages between scientific and technological institutions and development banks will be strengthened. Gaps in technology will be identified and suitable corrective measures taken with adequate allocation of resources. Fiscal incentives will be provided in particular to promote inventions, increase the use of indigenously developed technology, enhance in house Research and Development in industry, and efforts directed to absorb and adopt imported technology.

Capabilities in design engineering are essential for the translation of know-how to commercial production. Existing design engineering capabilities will be strengthened and upgraded, and interaction encouraged between design engineering organisations, academic and research institutions and industry.

Wherever capability exists, utilisation of Indian consultancy engineering organisation will be promoted. Even where foreign technical collaboration or consultancy is considered unavoidable association of designated Indian consultancy engineering organisations would be preferred. Indigenous engineering consultancy, in both private and public sectors, will be promoted on a sound professional basis in the context of the overall national perspective of technological self-reliance.

Mix of Indigenous and Imported Technology

A policy directed towards technological self-reliance does not imply technological self-sufficiency. The criterion must be national interest. Government policy will be directed towards reducing technological dependence in key areas. In the acquisition of technology, consideration will be given to the choice and sources of technology, alternative means of acquiring it, its role in meeting a major need, selection and relevance of the products, costs, and related conditions. Advantage should be taken of technological developments elsewhere. This can be achieved through well-defined collaborative arrangements in research and development. A National Register on foreign collaboration will be developed to provide analytical inputs at various stages of technological acquisition.

In response to the demands of new economic policy the government has formulated a new draft Technology Policy 1993. Salient features of the new policy are

1. Instead of spelling out individual thrust areas, a policy framework to approach areas of emphasis is given. This is in keeping with the idea of decentralisation and the role of industries and to create abilities to respond to users and markets.
2. Steps for linkages between institutions and users of technology are being elaborated.

Technical Consultancy Organisations (TCO)**TABLE - 2 Summary of Operations of TCOs Since Inception upto June 1985**

S.No. Types Services		For the year	Total since	
		(1983-84&1984-85)	inception	
(i)	(ii)	(iii)	(iv)	(v)
1.	Feasibility studies/project Reports/ Profiles	991	1019	9492
2.	Project Appraisals	338	356	1467
3.	Survey/studies-Industrial Potential survey, Market surveys, Area Development surveys	107	261	678
4.	Functional Industrial Complexes/ Turn key Assignments	-	7	N.A
5.	Rehabilitation/Diagnostic studies	91	115	667
6.	Other assignments	26	-	226
7.	Entrepreneurship Development Programmes conducted	67	80	266
	Persons trained	1851	1851	7400

Source: Report on Development Banking in India 1984-85

Activities of the TCOs During 1984-85**1) Andhra Pradesh Industrial and Technical Consultancy Organisation Ltd. (APITCO)**

During the year, APITCO prepared 37 project reports involving investment of Rs. 14.05 crores with employment potential for 1,716

persons. It conducted 12 EDPs and trained 360 persons aspiring to become entrepreneurs. In addition, one EDP was conducted for science and technology graduates. Important assignments handled by APITCO during the year included preparation of a report for establishment of an industrial estate at Yanam (industrially backward area) with an investment of Rs. 12.38 crores, provision of detailed engineering services for low cost automation and productivity improvement for Andhra Pradesh Electronic Equipment Corporation, action plans to identify right types of industries to be set up by trials in 4 districts, viz, Khamman, Visakhapatnam, Adilabad and East Godavari and adoption of Bheemgal block in Nizamabad district for formulation and implementation of development programs.

APITCO organised an international seminar on "Usage of Sponge Iron in Electric and Arc Melting Furnances" in July 1984 in which 17 delegates of user industries from U.S.A. Malaysia, Japan, West Germany, Austria and sabah participated. The seminar was sponsored by Sponge Iron India Ltd., and cosponsored by IDBI. A seminar on "Developments in the Plastics Industry" was organised in January 1985 which was attended by 167 participants representing raw material suppliers, machinery suppliers and processors. This was sponsored by Andhra Pradesh Plastics Manufactures' Association and kolsite Industries, Bombay. APITCO has been retained as retainer consultant by two companies, one at Delhi and other one based locally.

2) Bihar Industrial and Technical Consultancy Organisation Ltd. (BITCO)

BITCO completed, during the year 21 techno-economic feasibility reports, 5 rehabilitation reports, an industrial potential survey of East Champaran district and conducted an EDP exclusively for ex-servicemen. Other important assignments handled by BITCO included preparation of a report for manufacture of carbon black from phenol extract at Barauni which involved scaling down of technology to bring it under the purview of SSI sector and implementation of a small size textile processing house on turnkey basis. In the field of technology transfer BITCO helped an entrepreneur from Fiji for setting up an electronic unit in Fiji and associated a Patna based pharmaceutical formulation unit in procurement and finalisation of foreign know-how and collaboration with a French firm. With a view to attracting foreign investment in the State, BITCO opened NRI window. It opened another window for follow up and monitoring of projects promoted by participants of EDP help in patna. BITCO has opened an IRDP project office at Gaya and a branch office at Dhanbad.

3) Gujarat Industrial and Technical Consultancy Organisation Ltd. (GITCO)

During the year, GITCO completed 72 feasibility studies including those of a 20 tpd tiny cement plant and development of transport nagar at Rajkot for Rajkot Urban Development Authority. Project report on modernisation of industrial fabrics unit, MS re-rolled products and a turnkey project for manufacture of sodium silicate were completed. GITCO also made an innovative study for assessment of traffic prospects for setting up an Inland Container

Depot at Ahmedabad. GITCO undertook the task of establishment of Rural Industrial Development Centres at various locations in Gujarat. Under its Marketing Assistance Scheme, GITCO provided professional inputs in the area of marketing products of SSI unity by organising Counselling Clinics to 146 units at various places.

GITCO carried out market survey for assessing marketing potential for PABXs and allied products, pressure sensitive adhesive types from Caprihans, welding machines, etc. GITCO started a new programme in collaboration with VITA, U. S. A. under which brainstorming interviews were held with executive from renowned private sector companies, development banks and State level corporations with a view to identifying project ideas suitable for the environmental conditions of Gujarat. 50 Project ideas were generated during this programme and on the basis of two-way communication between VITA-GITCO, about 10 pre-feasibility reports based on availability of technologies have been prepared for technology transfer to entrepreneurs in Gujarat.

4) Himachal Consultancy Organisation Ltd. (HIMCON)

During the year HIMCON completed 93 pre-feasibility, feasibility and project reports including feasibility reports for setting up of hotels at various places of tourist interest in Himachal Pradesh. HIMCON organised 4 EDPs at Bilaspur, Nurpur, Mandi and Kulu resulting in training of 93 potential entrepreneurs. Detailed market survey was conducted for manufacture of intra-venous fluids. At the instance of HPFC, HIMCON carried out market surveys to examine the scope of mini cement plants and quick lime industries in the Sirmur district and also assessed the potential of small scale glass bottle industry.

5) Industrial Technical Consultancy Organisation Of Tamil Nadu Ltd. (ITCOT)

ITCOT came into existence in the year 1979 with a paid up capital of Rs. 10 lakhs. ICICI is the lead sponsoring institution. As on 30th March 1985 the paid up capital of organisation was contributed by several financing institutions as presented below:

TABLE - 3: ITCOT's Paid Up Capital Distribution as on March 1985

Institution	Share of the Institution (Rs.in Lakhs)	Percentage Shareholding
(i)	(ii)	(iii)
ICICI	2.60	26
Other All-India		
Financial Institutions	2.50	25
State-level Institution	2.50	25
Banks	2.40	24
Total	10.00	100

During 1981-82 the Organisation undertook 4 surveys at the instance of State/Central Governments. The Inter-Institutional Group in Tamil Nadu has been using the services of the organisation for setting up ancillary units for the automobile and chemical industries. The Organisation also had dialogue with ITI, Madras, regarding transfer of indigenous technology developed by it to industrial projects in special areas. During 1982-83 the organisation handled several as-

signments comprising 55 feasibility studies/project reports, 350 project profiles, 124 appraisals and 8 market surveys. Assignments handled by the Organisation during 1983-84 included 65 feasibility/project reports, 110 project appraisals, five market surveys and a survey of Adi-Dravidas residing in slum areas of Madras City. It also conducted two EDPs which benefited 77 persons.

During the year 1984-85 ITCOT prepared 46 feasibility reports for projects envisaging investment of Rs. 11.86 corers and with employment potential for 1,500 persons. Completion of 6 markets survey reports for small and medium scale projects, preparation of 23 plant visit reports for modernization of small and medium scale industries which had approached SFCs and commercial banks for term loans under IDBI refinance scheme for modernisation were among the major activities of ITCOT during the year. ITCOT adopted two blocks, viz., Palani in Madurai District and Rasipuram in Salem District under IDBI's block adoption scheme. ITCOT organized an EDP, during the year at chennai exclusively for 33 women entrepreneurs with sponsorship of IDBI, ICICI, IFCI, SIPCOT, TILC, Indian Bank, Indian Overseas Bank, Canada Bank and Tamil Nadu Corporation for Development of Women Ltd. Out of the 33 women entrepreneurs, 8 have already set up their projects and 15 other projects are in various stages of implementation. ITCOT proposes to diversity its activities by extending, marketing assistance for products of small scale industries and by undertaking turn-key assignments.

6) Jammu & Kashmir Industrial Technical Consultancy Organisation Ltd. (J & KITCO)

During the year, J & KITCO completed 39 feasibility reports involving investment of Rs. 2740 crores and with employment potential for 2,725 persons. The reports related to setting up of units for manufacture of various products such as silver knitted pile fabrics, soft drinks, auto bulbs, iodised salt, cement (mini plants), steel ingots, distillery, pharmaceuticals re-rolling mills, edible oils, etc. At the instance of the state Government, project profiles under Self Employment Programmes (SEP) were prepared for 14 districts of the state. J & KITCO undertook diagnostic study of cold storage and crockery units in the state. Market study on raw material availability and demand for solvent extraction products in the state was undertaken. The survey of NIDs of Pulwama Udhampur Districts were completed.

7) Kerala Industrial and Technical Consultancy Organisation Ltd (KITCO)

During the year, KITCO completed 65 feasibility/ project reports involving a total investment of Rs. 22.83 crores and with employment potential for 2,299 persons. It completed 9 rehabilitation/diagnostic studies. Out of 15 EDPs conducted by KITC, 8 were for SC/ST entrepreneurs at Ernakulam and Quilon. Follow-up of entrepreneurs trained during the earlier years indicated that 30.1% of the persons trained in 1982-83 and 20% in 1983-84 have already set up their own units. The assignment of monitoring of projects of Kerala Minerals & Metals Ltd. (KMML) and Malbar Cements was extended by one more year. KITCO was selected to act as Indian consultant

by Marine products Export Development Authority for full implementation of their prawn farming and hatchery project at Vallarpadam Island near Cochin including design and construction of building etc. KITCO has been appointed as consultant by Air India for electrification of computer installation as well as modification of resent electrical system, etc. At the instance of KSIDC, KITCO conducted market surveys for multi layer plastic film and printing press. KITCO has published idea of 'foster management' among entrepreneurs in the Gulf countries.

8) Madhya Pradesh Consultancy Organisation Ltd. (MPCON)

During the year, MPCON completed 351 feasibility/project reports relating to various products such as TV booster, PVC shoes, hosiery wooden/steel furniture, ready-made garments in tiny sector, fabrication units, ayurvedic medicines, B/W TV sets, cement (miniplants), etc. It conducted three market surveys for (i) cement around Dhar district (ii) ferric/non-ferric alum in Chatisghar region and (iii) a three star hotel in Bhopal. Out of the 20 EDPs conducted by MPCON for training 559 persons during the year, 11 were exclusively for tribal entrepreneurs. MPCON along with Council of Scientific and Industrial Research and other institutions has decided to provide jointly a cluster of units at a science and technology park at Mandideep based on newer technologies developed at regional Research Laboratories of India. Other major assignment as handled by MPCON included survey of Nids Jhabua, Guna, Dhar and Sidhi, preparation of a project report on leather board for a 100% export-

oriented unit proposed to be set up by a non-resident India, study on data processing centre in the small scale sector, three socio-economic survey of village which are likely to emerge in the process of implementation of the Narmada Sugar Complex Scheme and preparation of a draft of the five year plan for the Directorate of Industries, Government of Madhya Pradesh, with a separate plan for industries in the dacoity infested area.

9) Maharashtra Industrial and Technical Consultancy Organisation Ltd. (MITCON)

During the year, MITCON completed 47 feasibility studies/project reports which include the feasibility report on quality Test Centre assigned by MSSIDC. It conducted EDPs in which 102 potential entrepreneurs were trained. Market surveys were carried out for products such as canal lining tiles, steel castings and citrus products. At the instance of Unique Solid Fuel Pvt Ltd., Jalna, an assignment was completed for manufacturing of briquetted fuel renewable source of energy of energy from agro waste viz. cotton stalk. Diagnostic studies were carried out by MITCON for (i) Dini chemicals to modify its present process for manufacture of glue flakes and (ii) Speedicut Small Cutting Tools Pvt, Ltd. for manufacturing precision cutting tools used for automobile and diesel engine industries. Project report for Electronic Design & Technology was prepared for Marathwada Development Corporation, Aurangabad in association with Department of Electronics, Bangalore. Along with ITCOT MITCON carried out survey of plastic industry in India with special reference to downstream industries of Maharashtra Gas Cracker Complex prepared of

Bureau of Industrial Costs & Prices, Government of India, New Delhi. A project report for establishing a Products - cum - Training Centre for Kushta Rog Niwaran Samiti near panvel was completed by MITCON for IDBI. Techo-economic feasibility report prepared by DEMECH was revised/re-worked by MITCON for supplying 50 tpd capacity mini cement plant to the Republic of Somalia. Africa on turn-key basis. Vidarbha Documentation Index was prepared by MITCON to develop further course of action for studies to undertaken in vidarbha.

10) North Eastern Industrial and Technical Consultancy Organisation Ltd. (NEITCO)

During the year, NEITCO prepared a number of feasibility/project reports such as for setting up a unit for manufacture of RCC pipes at Kumarghat, unit for manufacture of veneer-cum-saw mill at Dimapur and oxygen unit at Silchar. NEITCO has drawn up a plan of action to help generate momentum for electronics production in North East with the setting up of an electronic components complex and electronic equipment (systems) complex. Besides, the plan of action outlines the need for a Centralised Test and Development Centre as well as Compute Aided Design facility and computer Data Processing system. NEITCO participated in "Electronic USA 1985" - an exposition -cum-seminar on development of electronics in the eastern region of the country organised by the American Consulate in Calcutta. This resulted in NEITCO's tying up of consultancy-cum-project implementation arrangements. NEITCO has carried out a study on incidence of additional cost bur on industrial ventures in the

North-Eastern Region and advocated single point subsidy, instead of providing incentives thinly spread at several points in order to facilitate more realistic orientation of incentives and subsidy structural. NEITCO has commissioned the first cement plant at Teze, Arunachal Pradesh and a mechanised yarn dye house at Gauhati, both being turn-key projects. NEITCO has completed preparation of comprehensive industrial development programmes for NIDs in Tripura, Manipur and Meghalaya and schemes for establishments of nucleus project complexes in Tripura, Mizoram, Manipur and Meghalaya. As compared to their agencies, NEITCO's high success rate in conducting EDPs in the North Eastern Region has been due to (a) its commitment to programmes on continuing basis (b) securing long term support from sponsoring agencies (c) its emphasis on scientific selection procedures, sustained after-training follow-up for considerable period and (d) its affiliation with professional bodies engaged in similar activities. NEITCO has on hand project implementation and co-ordination work in respect of a starch & glucose project at Imphal in Manipur. NEITCO will take up EDP programmes exclusively for science and technology graduates and women entrepreneurs. Besides, NEITCO has set a target of training 1,000 entrepreneurs in the next five years.

11) Orissa Industrial and Technical Consultancy Organisation Ltd. (ORITCO)

During the year, ORITCO completed 31 techno-feasibility reports involving an investment of Rs. 27.57 crores and employment

potential for 2,241 persons. EDPs at Talcher, Bhanjanager, Sambalpur, Balasore and Rourkela were conducted by ORITCO during the year for training 120 persons aspiring to be entrepreneurs. In the survey report on NID Phulbani, ORITCO has identified 22 industries with investment potential of Rs. 140 crores and employment potential for 7,000 persons. Among the other major activities handled by ORITCO during the year were preparation of feasibility reports on two medium sector projects, viz, industrial & decorative laminates for Toshali Laminates and PVC foam leather cloth for Maa coated Fabrics and two powerloom projects at Anandpur and Bhagrai, rehabilitation studies for five projects involving a total capital cost of Rs. 222 lakhs and employment of 554 persons, completion of status studies on drugs and pharmaceuticals and ceramics industries in Orissa and a viability study of Utkal Carbon Electrode Paste Ltd., for its acquisition by Orissa Mining Corporation. A seminar was conducted by ORITCO on rehabilitation and modernisation of industries in collaboration with SISI.

12) Rajasthan Consultancy Organisation Ltd. (RAJCON)

During the year, RAJCON completed 65 feasibility studies/project reports in respect of a wide variety of products such as mosaic floor polish hand-block printing of cotton cloth P.P. Caps and crown cork caps and cement (mm) plants of 20 tpd and 100 tpd, etc. Some economic research studies on the pharmaceutical, stainless steel and steel furniture industries were carried out. Than assignments were

completed by RAJCON for SC/ST entrepreneurs during the year. The draft reports prepared by RAJCON in respect of NIDs Churu and Sirchi have been submitted to IFCI. Assignments for diagnostic studies of 6 sick units were completed and recommendations for their revival made. With the support of EDII < two. EDPs were conducted by RAJCON during the year. One EDP was organized at Kishangarh in the backward district of Alwar and another at Jaipur for science and technology graduates. Under IRDP, RAJCON adopted Kishangarh block Panchayat Samiti in Alwar district and submitted an action plan to IDBI, RAJCON is now handling studies on NID-Barmer and for a sheep and goat meat processing plant in the western desert district of Rajasthan as also an industrial potential survey of the tribal areas in Rajasthan.

13) Uttar Pradesh Industrial consultants Ltd. (UPICO)

During the year, UPICO completed 55 project feasibility reports and 40 project profiles. It conducted 10 EDPs in which 327 persons were trained. Report on HBEL ancillary unit at Jagdishpur and the first phase of a feasibility study on natural gas supplies to glass industries in Firozabad/Shikohabad were some of the major assignments of UPICO during the year. Under IRDP, a full time executive has been appointed by UPICO to survey each village in the block of Chaubepur for identifying local skills, before drawing up a suitable development programme for the block. UPFC has awarded three assignments to UPICO viz., (a) improvement of dis

bursement procedure (b) Survey of chrome tanning/vegetable tanning/skin tanning units and (c) market study on micro cellular rubber sheets.

14) West Bengal Consultancy Organisation Ltd (WEBCON)

During 1984-85, WEBCON conducted two EDPs, at Purulia and Calcutta exclusively for women and another EDP was organised in collaboration with EDII, at Gangtok. A week long EDP on Project Appraisal and Management of Corporate Industrial Enterprises was also conducted in Sikkim. Of the surveys of four NIDs undertaken by WEBCON during the year three in West Bengal and one in Sikkim two in respect of Malda and the East district of Sikkim were completed. WEBCON's other assignments during the year included a marker survey on the status and prospects of offset printing press in the districts of Calcutta, Howrah, Hooghly and 24-Parganas, techno-economic feasibility report on malleable iron casting unit (900 tpa) at Barjora, Bankura, relative cost study of passenger and cargo transport between the islands of Andaman and Nicobar and the main land and a study on status and prospect of biscuit industries in West Bengal. WEBCON organised a two-day seminar on "Industrial Opportunities and Incentives-West Bengal," which was sponsored by IDBI and the Government of West Bengal.

REVIEW QUESTIONS

1. What is technology ? What is its influence on business ?
2. Bring out the interface between technology and business.
3. Bring out the salient features of our technology policy.
4. What are the paradoxes noticed in technology front in our country ?
5. What are the institutions assisting entrepreneurial development ?
6. What are functions of District Industries Centres ?
7. How does Indian Investment Centre promote entrepreneurial development ?
8. What are the functions of Technical Consultancy Corporations ?
9. Explain the role to Technical Consultancy Corporations in identifying and for and formulating projects at State levels.
10. How does State Bank of India promote entrepreneurial development ?

MARKETING AND EXPORT PROMOTION

Introduction

A number of new units are planned and started by the entrepreneurs 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 item and encouraging the entrepreneur to set up an ancillary manufacturing unit for the said item.
- 3) The entrepreneur noting a shortage of a particular item in a market and premium being paid by consumers for the said item.

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 finance to invest. However, he forgets that there may be many others like him with the same idea and also with money to invest. As a result, too many people enter the same field of activity and a situation of over capacitive arises. This leads to an under-cutting of selling prices, reduction in margin and eventually, even, closing down of several of the units.

In the second case, one would feel that since the sales are assured the ancillary unit will and must do well. In most cases, this would be true, but here also there are pit-falls which often bring grief to the ancillary units.

Example: If the ancillary unit is supplying its full production to only one consumer, the consumer can often dictate the prices. Further, if the has to close down for any reason, the ancillary unit would be equally effected.

The third case, may present a very rosy picture in the earlier stage but the situations can change very quickly. A change in Government's Import Policy or an increase of capacity by establishment or expansion of a large unit or the restarting of a shut down nit, can make shortage disappear and can create difficulty for the units.

Hence, the suggested process to follow when setting up an SSI unit, is to first have a market survey conducted to ascertain the true demand and supply position and also collect information on the other entrepreneurs planning to enter this field. Once it is established then there is a good possibility of the unit being able to establish it self a reputation, Market Development Program should be undertaken. This is essential in order to ensure that the unit does not suffer for want of sales, once the production has commenced. The role of marketing, therefore, commences even before one takes a decision to put up a manufacturing plant for a particular item or starts a business enterprise.

Need for Market Survey

A new entrepreneur taking the risk of setting up an enterprise and managing it successfully depends only on how he makes his decision in conditions of uncertainty. Uncertainty, involves both risk and opportunity. Market for the product of his venture must therefore be examined and analysed thoroughly before plunging into it.

Market research/survey is a tool through which, though it may not be possible to eliminate the risk or guarantee an opportunity, its intelligent and systematic use can reduce risk and improve the probability of success.

Markets are becoming increasingly dynamic and competitive, therefore, successful exploitation calls for greater investment and more frequent INNOVATIONS. Decision making therefore, must be faster and less susceptible to many of the needless errors of INTUITIVE judgment. Thus, instead of a hasty decision to start the venture, it is advisable to undertake a detailed market survey and understand the market and the feasibility of "marketing your products".

Contents of Market Survey

Market research or survey may be defined as an "objective and systematic collection, recording analysis and interpretation of existing or potential markets, marketing strategies and tactics and the interaction between markets, marketing methods, of current or potential products/services. Thus, it helps to apply a truly analytical approach to decision-making and assist in the evaluation of the effect

of decisions, which have been taken.

The objective of the survey should be to answer the following questions.

- a) What is the size of the market and share anticipated for a product /service in terms of volume and value ?
- b) What is the pattern of demand ?
- c) What is the market structure ?
- d) What are the buying habits and motives of buyers ?
- e) What will be the unit's strong points in marketing? i.e., (U.S.P)
- f) What are past and future trends

Steps in the market's survey

For new entrepreneurs, the process involves all the following steps, though complete sequence may not be adhered to, an attempt should be made to cover and get all information.

- 1) Defining objectives of the study and specifying information required.
- 2) Working out the details of the study which include
 - a) Identifying sources of obtaining information
 - b) Time and cost involvement in the study
 - c) working out methodology and action plan.
- 3) Selecting samples and deciding contacts and visit.
- 4) Preparing Questionnaires and plans for survey and interviews.
- 5) Collecting a data and analysis of data.
- 6) Preparation of a report with findings.

For new entrepreneurs, a major problem in conducting market survey is not knowing sources and contacts for getting information. The best way is to try for it without having fear of not getting information. It is because the information itself is not the only important element. What is more important is to get the feel and direct experience of market, during personal visits.

The information sources can be divided into

- 1) Primary data sources.
- 2) Secondary data sources.

1. Primary data sources is information which originates as a result of the contacts with those who are directly involved in relevant activity.

Example: In survey for plastic toys, information obtained from toy manufactures or traders or children who play with those toys would be primary data.

2. Secondary data sources refer to the data which already exist and may be used for the investigation. They are or have not been collected for a specific purpose. This information may be obtained from those who are indirectly involved.

Example: Trade or manufacturers associations or published data in journals are secondary sources.

Suggestions for Conducting Market Survey

It is important to note that for entrepreneurs, the survey and getting information is very important but not for those who are going

to supply the information. Thus, intelligent efforts will have to be made to get information out of them. Following tips can help entrepreneurs in conducting the market survey effectively and systematically.

- 1) Not to be prejudiced or status conscious. Since these act as a negative factor in collecting information from various levels of people.
- 2) To keep cool and patient so as not to enter into arguments which will not illicit information
- 3) Not to collect information for other use.
- 4) Noting down the information immediately.
- 5) Avoid referring to papers during interviewing.
- 6) Sequencing of questions.
- 7) Involvement and commitment to get informations.

At the end of the survey, detailed report on findings must be prepared in a written form.

This market survey report, will not only help in assessing the feasibility of marketing product but will also act as an important document to convince financial institutions about your understanding of the market and chances of success.

Model Questionarie is attached in Annexure 1 Contents of Market Survey Report are outlined in Annexure II>

FACETS OF MARKETING

A layman normally confuses marketing with sales. However, sales is only one of the activities of marketing, especially for small busi-

ness. Marketing encompasses the following activities:

- 1) Research
- 2) Planning
- 3) Branding
- 4) Pricing
- 5) Distribution
- 6) Selling
- 7) Packaging
- 8) Merchandising
- 9) Warehousing
- 10) After-sales-service
- 11) Sales Promotion
- 12) Advertising
- 13) Credit control

1. Research : This would be a never ending activity through the existence of the SSI unit. It starts with a market survey to establish a demand and supply position, in order to determine the feasibility of setting up a unit for the manufacture of a particular item. Once the feasibility is established, research is required to identify the consumer 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/service as a consumer sees it and consumer satisfaction must be the main criteria for evaluation of all policies and actions.

Even after the enterprise has been established, research must

continue on an on going basis to improve the product, packaging, distribution system, etc.

2. Planning: This activity starts at the project stage and is extremely necessary throughout the life of the project. At the project stage, this would include activities such as planning, market development; development of packing setting up distribution networks, warehousing, short term and long term sales planning.

After the unit is in production it will include sales planning. The sales plan will include a forecast of sales for the future, a plan for territorial coverage, a programme to achieve the forecasted sales and a sales promotion plan if required.

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

- 1) It enables the consumer for an effective and easy identification of the product.
- 2) The manufacturer benefits since the consumer seeks for is specific brand.
- 3) It enables the consumer to have a better control over the sales outlet and price of the product.
- 4) If the brand is popular it benefits the retailer by attracting consumers to his sales outlet enabling him to sell other products also and overall increase his sales.

When selecting the brand name the following should be kept in mind.

- 1) Brand should be easy to remember
- 2) Brand should be able to create an image of the product.
- 3) It should be easy to pronounce.
- 4) It should be protectable (name should be such that it can not be copied easily i.e. without infringing patents)
- 5) Brand should be short.

4. Pricing: The prices is usually associated with 1) Value, 2) Status, 3) Quality 4) Durability

It is worth while to remember that a consumer is more sensitive to price when the purchase frequency is high or when the quality of competing products is more or less the same.

Example: Hardware, matches, gums, stationery, chemicals, etc.

However, when a consumer detects quality variation in brands the price becomes immaterial.

Example: Razor blades, toilet soaps, cars, machinery, designer wear clothes.

There are five different methods that can be employed in pricing.

- 1) Pricing in line with similar products already in the market
- 2) Pricing slightly higher than the price leader in the market.
- 3) Pricing slightly lower than the price leader in the market.
- 4) Pricing on a cost plus basis.

5) Pricing on the basis of profit yield/percent at different sales level.

When fixing the price of products the following questions should be asked.

- 1) What range of price will make the product economically attractive to the consumer ?
- 2) What sales volume can you expect at different price levels ?
- 3) What will be the competitors reaction to your price ?

Attempts at answering these questions sincerely, will help the entrepreneurs in rational pricing.

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

- | | |
|-----------------|------------------------|
| 1) Agents | 5) Manufacturers' shop |
| 2) Stockiest | 6) Retailers |
| 3) Wholesalers | 7) Street Vendors |
| 4) Distributors | 8) Mail Order |

The selection of sales outlet will depend on the nature of product number of consumer and the financial resources.

Distribution channels can be

- 1) Manufacturer → Consumer

Example: Industrial Machinery, Consumer goods (Godrej)

- 2) Manufacturer → Wholeseller → Retailer → Consumer

Example: Consumer Goods (BATA)

3) Manufacturer → Retailer → Consumer

Example: Oils

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 when assessing the performance of sale staff and also when finalizing terms with agents, distributors, etc.

The most effective method of selling is personal selling i.e, through own trained staff. This is so since, no agent, distributor, stockiest or dealer would know your producer or its plus points as well as your own trained staff would. However, it is seldom possible for a SSI unit to resort to personal selling since it cannot afford large sales organisation to cover the vast geographical areas of the country.

Whenever personal selling is resorted to compensation to salesmen is in term of.

- 1) Salary
- 2) Salary cum Commission
- 3) Commission cum Retainer
- 4) Commission

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

- 1) Merit Awards
- 2) Salesmen's Meetings
- 3) Contests

In case of operating through 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, whenever selling through outside agencies are involved, it is essential that sales staff of such agencies be given suitable product training and also sufficient sales aid to make them more effective.

7. Packaging: The basic reasons for packaging are.

- 1) To hold the product
- 2) To protect the product
- 3) To attract customers

When selecting the kind of packaging to be used besides keeping the above reasons in mind, one should also look into the cost of using such packaging.

8. Merchandising: It is the art of displaying the products at a point of sale so as to catch the customer's attention, highlighting the plus points of the product and luring the consumer into buying the products. This are is mainly applicable in case of consume goods and consumer durables. Use of display windows, attractive and eye catching display of the product on the shelves and sales counters, hoarding and

billboards outside the sales outlet are some of the methods used in merchandising.

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 are limited both or outside octroi limits and manufacture himself outside octroi limits, storage of products outside octroi results in financial 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 is selling inter-state results in financial savings.
- 3) Where transit times are considerable and consumers are not likely to wait for extended delivery period ware housing of goods in the 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 near the consumers, financial savings can be effected.
- 5) Where excise duties are high and a substantial stock is required to be maintained, operating excise bonded warehouses result in financial savings in terms of interest on the duty value of duration of storage.

The above factors and others which may be specific in relation

to the products should be considered when finalising warehousing arrangements.

Example: Cold storage warehouses for food items fruits vegetables etc.

10. After - Sales - Services : This is a very important activity which is completely ignored by many organisations. Most of the SSI units are started by traders, 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 had to manufacture the same product, make repeat sales to the same consumers on an ongoing basis. Hence, any dissatisfaction of the customer would effect his future sales. It is worthwhile to remember that a dissatisfied customer can make not only a dent in future sales but also effect reputation. In case of any complaint, by the customer prompt action in solving the complaint will usually result in the customer's single praises and forgetting the initial complaint.

In general smaller the organisation, the better should be the after sales service, so as not to effect the overall volume of sales.

11. 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 for sales promotion are.

- 1) Offering special discount for a particular time period.
- 2) Tying up sales of the product in demand with slow moving items.
- 3) Starting a contest with attractive prizes and the entry fee being cash memo and wrappers of the product.

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

Example: 1) Bata, Garden Mills Second's Sale.

2) Consumer durable exchange scheme.

Example : Old TV for Akai new TV.

3) BPL loan scheme

12. Advertising : There is a misguide impression in the minds of many people that advertising is an expensive proposition and can only be resorted to by large units. This impression arises because most people associate advertising with dailies and magazines, radio and television. There are, however, other less, expensive ways of advertising. The different media are.

- 1) News papers
- 2) Radio
- 3) Television
- 4) Hoardings and neon signs.
- 5) Bus and train panels.
- 6) Bill boards

- 7) Cinema slide and short film advertisement.
- 8) Stalls and exhibition at fairs.
- 9) Direct mailing of literature
- 10) Demonstration

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 judicious manner based on the class of consumers one wants to send the message to and the cost of the media used in relation to results expected. An entrepreneur must develop uniqueness for his product. It must have one strong selling point which is called 'unique selling proposition'.

<i>Example:</i> Fair and Lovely	- "Husbands are like that".
Colgate	- "Remove bad breath"
Forhans	- "Protects gums"
Saridon	- "One tablet is enough"
Pudinbara	- "Natural, no side effects"

Since an entrepreneur will have to be a first and foremost a salesman of his product because his ability to sell would distinguish him from a successful entrepreneur or not, he should.

- a) Have
- b) Take interest in selling
- c) Have through knowledge about his product/competitor's product.
- d) Stay upto date
- e) Never stop learning

- f) Give good service to customers
- g) Be creative.

13. Credit Policy: An SSI unit, can succeed or fail based on the credit policy it adopts or fails to adopt.

It would be wonderful if all sales of products or services resulted in receipt of cash immediately. But for a new entrepreneur, the fact is that he has to pay in cash and sell on credit. It is a sale on trust, as and when credit is extended one must always fix the value limit and time for each debtor, and under no circumstances must the debtor be allowed to stretch the agreed terms. A single relaxation will become a permanent future. Regulars reminder, seven days before a payment is due and on due date of payment must form a part of the routine credit policy.

Regulars statements of accounts must also be mailed at the end of each month so that the party has no opportunity of pleading differences between the accounts of seller and buyer.

The known formula to give credit is three 'C's, i.e. Customer, Credit, Character. It is better to evaluate, examine, customer before selling them goods on credit. Ascertaining how fair they are in their dealing would also be of great use.

It is better not to sell than to take the risk of not receiving your money. Selling to the rightly party with right credit policy is important. Inspite of all these business means risk-taking and giving credit also assumes risks, and selling goods on credit is the requirement of this competitive world, hence, the

risk can be minimized, if sound credit policy is consistently followed and proper procedures are adhered to.

Annexure I

QUESTIONNAIRE FOR MARKET SURVEY

The following questions and information, will help entrepreneurs, to collect information and in turn will enable them to understand the nature of the business. The sample market survey suggested here is in a broader perspective, so that the entrepreneur may have all round commercial information.

It is divide into three parts viz.

- 1) Raw Materials
- 2) Machinery/Equipments
- 3) Market: a) From Manufacturers - Competitors (b) From Suppliers (traders). (c) From Consumers (customers)

1. Raw Materials

- a) Who are the major manufacturers/suppliers of the material ?
- b) Who time, is required to get the materials after ordering ?
- c) Which terms of supply prevail ?
- d) What is the standard/minimum packing or minimum order quantity ?
- e) Is the material freely available ?
- f) Are there any shortages (created) in the market at any particular time of the year ?
- g) What was the trend of price changes and availability in the past two years.

- h) Will tube advantageous to procure the material locally or purchase from outside ?

2. Machinery / Equipments:

- a) Who are the manufactures/suppliers ?
- b) What capacity, specifications and makes (brands) are available in the market ?
- c) What is the price of machines ?
- d) What electrical are required ? (motors, starters, switches, etc.)
- e) What guarantee/warranty of performance is given by the manufacturer ?
- f) What is maintenance cost each year ?
- g) Which spares or part are frequently required ?
- h) What are the terms for ordering, payment, advance, delivery time etc ?
- i) Where can inspection be done ?
- j) What is the market standing of the manufacturers ?
- k) Which are the parties to whom same type of machines are supplied ?
- l) Will special type of handling and transport be required ?
- m) What are the overall outer dimension of the machines and working floor area requirements ?
- n) What average, maximum quality standards and output/production can the machine give ?

3. Market

1. From Manufacturers - Competitors.

- a) What is the general factory layout and space occupied ?
- b) What are their range of products, installed capacity and selling price ?
- c) What are their terms of business ?
- d) What are their future plans for expansion and diversification ?
- e) What is their market and their strategy ?
- f) What are the problems faced by them ?

2. From Suppliers (traders)

- a) Who are the present principal traders ?
- b) What are their range of products and business terms ?
- c) What is their market area ?
- d) What is their annual turnover estimates ?
- e) What are the possibilities of trading with him ?
- f) What are his expected business terms. ?
- g) What is the normal level of stock he maintains and how are his delivery schedules ?

3. From Consumers (customers)

- a) What is the annual consumption and requirement ?
- b) What are the present sources of supply ?
- c) Customers loyalty to Brand (make) and preference like price, quality, payments, terms etc.
- d) Whether he is satisfied or dissatisfied with present prod-

uct and supply ?

- e) What are his purchasing criteria and what purchasing power he holds ?
- f) What is the consumption pattern ?
- g) What changes he expects in his future consumption in quantity and quality ?
- h) What is the size of his average order quantity ?
- i) What is his frequency of ordering ?

Annexure II

COMPONENTS OF MARKET SURVEY REPORTS

I. Introduction:

- End products
- End users
- Suitability and strength or particular product

II. Product

- Specification, sizes, brands, packing selling price etc.

III. Assessment of demand:

- Class and type of consumers
- Patterns of consumption and frequency of purchase
- Product life cycle and present status
- Post demand pattern
- Future anticipated demand
- Buying criteria

IV. Supply position

- Current availability

- Production capacity Vs utilization
- Present indigenous and imported sources
- Price comparisons, serviceability criteria

V. Marketing practices

- Prevailing marketing practices with respect to
 - Distribution
 - Packing
 - Credit Policy
 - Delivery and after sale service.
- Selling price taxation structure and commission pattern
- Purchasing procedures

VI. Marketing plans

and strategies:

- Own market share of supply-demand gap
- Special services to be offered if any
- Specific strength of the venture
- Possible clientele

EXPORT PROMOTION

Foreign trade is a major component of economic environment. Role of foreign trade, direction, composition regulation, promotion and problems are the issues relevant to external trade. Regulation of overseas trade was covered in Chapter 18. Other aspects (with reference to exports) are covered in this chapter.

Significance of Exports

Exports are crucial for our economy for several reasons.

1. We need export earning to finance our imports. Imports would tend to grow as the economy grows further. We would be required to spend more foreign exchange earnings on import of oil, investment -induced inputs, and technology. This calls for massive export earnings.
2. It is not advisable to depend on external assistance to finance essential imports. It is necessary that we depend on our own feet, earn on our own, and use the same to buy essential items from exporting countries.
3. We have huge debts and we need foreign exchange earnings to service the debts. It is bad policy to contract new loans to service old debts. Old debts must be liquidated hence we need more and more export earnings.
4. Exports would make our economy highly vibrant. Exports call for quality products produced at reasonable costs. Industrial establishments must be strong in fundamentals to

achieve high productivity. Exposure to foreign markets would compel domestic industries to become more competitive

5. Competitive firms would optimise resource utilisation. Consequence would be increased supply of goods and services. Added to this are the increased production capacities of plants resulting from upgraded technologies. As days go by supply would outstrip domestic demand leaving exportable surplus. Surplus would necessitate exports.

Export Strategies

Two strategies are suggested by economists while discussing the role of exports in an economy. The strategies are export-led growth and growth - led exports.

Export-led growth

This considers exports as additional or alternate source of demand which would initiate/accelerate domestic growth and/or counteract stagnation or recessionary tendencies in the home economy. The economy gets export-oriented and everything is produced keeping exports as target. The economy obviously becomes subservient to the international market. Korea, Taiwan and Brazil have followed this strategy and have achieved tremendous economic prosperity. We did not, it is pointed out, pursue the export-led growth strategy and hence our growth rate has been very low. So is the case with Argentina and Egypt.

Export-led growth strategy promotes faster economic growth because of two reasons.

1. It provides demand - stimulus growth because of the unlimited world market available for exports. Because of unlimited demand entrepreneurs are motivated to set up new plants and expand existing ones. More demand means more productions. There is a boost to economic growth.
2. It promotes efficiency. There will be optional utilisation of resources.

Growth-led exports: In this strategy the production pattern is influenced by domestic demand. Production of export-goods forms part of the economy. Exports are viewed as means to earn foreign exchange to pay for imports.

We followed growth-led exports strategy for two reasons. Our domestic market itself is vast to sustain faster economic growth. We need not look to outside markets for demand. Secondly, our economy has many socio-economic objectives to achieve. These include reduction in inequalities of incomes, elimination of poverty, balanced sectoral and regional development, employment generation and the like. These require specific policies and allocation of resource which are possible only if the growth led exports strategy is followed.

Extent of Exports.

Adopting growth-led exports strategy, we promoted export of specific products where we enjoyed competitive advantage. As table 5.1 shows, our exports increased by almost six times from 1985-86 to 1993-94. During 1985-86 the export earnings were Rs. 10895 cr.

The figure went upto Rs. 69,751 cr. during 1993-94.

An interesting feature of our exports has been the growing coverage of imports by export earnings, thus reducing the current account deficit (see table 5.1)

In the beginning of the eighties, the coverage ratio was only 52.4 percent which led to a massive trade deficit. This had improved to about 70 per cent by the end of the previous decade. As table 26.2 shows, during the last three years export earnings have, on an average, accounted for nearly 90 per cent of the value of imports. This marked improvement in the export - import ratio has resulted in a sharp reduction in the current account deficit, which has come down from unsustainable levels of more than two per cent to less than half a per cent during 1993-94.

Table 5.1 India's Foreign Trade

Year	Exports	Imports	(Rs.Crores)
			Balance of Trade
1985-86	10895	19658	-8763
1986-87	12452	20201	-7749
1987-88	15741	22399	-6658
1988-89	20232	28235	-8003
1989-90	27681	35416	-7735
1990-91	32553	43198	-10645
1991-92	44040	47851	-3810
1992-93	52688	63375	-9687
1993-94	69751	73101	-335

(Source: Govt. of India, Economic Surveys)

Table 5.2 Exports as a per cent of Imports

1980-81	-	52.4
1985-86	-	54.7
1986-87	-	58.7
1987-88	-	63.8
1988-89	-	60.4
1989-90	-	69.5
1990-91	-	66.2
1991-92	-	86.7
1992-93	-	81.2
1993-94		94.6

(Source: Govt. of India, *Economic Survey, 1994-95*)

With regard to the composition of exports, it may be stated that the manufactured goods constitute 76 percent of the total exports, followed by agriculture and allied items (17 percent) ore and minerals (4 per cent), crude and petroleum products (2 percent) and the balance by unclassified items (Table 5.3)

Table 5.3 Composition of India's Exports

Commodity Group	1992-93	1993-94
I. Agriculture & allied, of which	16.9	18.0
1. Tea	1.8	1.4
2. Coffee	0.7	0.8
3. Cereals	1.9	1.9
4. Unmanufactured tobacco	0.7	0.5
5. Spices	0.7	0.8
6. Cashew	1.4	1.5

7. Oil meals	2.9	3.3
8. Fruits & Vegetables	0.6	0.6
9. Marine products	3.2	3.6
10. Raw cotton	0.3	0.9
II. Ores and minerals, of which	4.0	4.0
11. Iron ore	2.1	1.9
12. Processed minerals	0.8	0.9
13. Other Ores and Mineral	1.0	1.0
III. Manufactured goods, of which	75.6	75.5
14. Leather & manufactures	4.7	3.8
15. Leather footwear	2.2	2.2
16. Gems & Jewellery	16.6	18.0
17. Drugs, pharmaceuticals & fine chemicals	2.9	2.9
18. Dyes/Intermedates & coal tar chemicals	1.8	1.6
19. Manufactured of metal	3.0	3.1
20. Machinery and instruments	2.9	2.9
21. Transport equipment	2.9	2.6
22. Primary and semi-finished iron & steel	0.9	1.9
23. Electronic goods	1.1	1.4
24. Cotton yarn, fabrics, made ups etc	7.3	6.9
25. Ready made garments	12.9	11.6
26. Handicrafts	4.7	4.2
IV. Crude & petroleum products	2.6	1.8
V. Other & unclassified items	0.9	0.8
Grand Total	100.0	100.0

Coming to the direction of trade-LDCs account for a major share (25 per cent), followed by U.S.A. (19 percent), and E.U. Countries (13 Percent), and the rest contributed by many other countries (Table 5.4)

Table 5.4 Direction of Exports

	1992-93	1993-94
U.K.	6.5	6.3
Germany	7.7	6.9
Other E.U. Countries	14.1	12.2
U.S.A.	19.0	18.5
Japan	7.7	7.7
Russia	3.3	2.4
East Europe	1.1	1.0
OPEC	9.6	10.4
LDCs	20.8	24.5
Others	10.1	10.2

(Source: Govt. of India, Economic Survey 1994-95)

Promotional Measures

After the recent drastic policy changes, government has practically removed all export promotion and incentive measures which can be deemed as a subsidy. In this section, we briefly comment on some of the existing measures. We have also included some of the earlier measures which have now been removed to give a complete background.

(1) Advance License Scheme

An advance license is granted for the duty free import of raw materials, components, intermediates, consumables, parts, spares (including mandatory spares) and packing materials.

Such licences shall be subject to the fulfillment of a time-bound export obligation and value addition as may be specified. Advance licences may be based on either value or quantity. An exporter may apply for a value based or quantity based advance licence.

2) International Price Reimbursement Scheme (IPRS)

This scheme is introduced with a view to make available to exporters raw materials at international prices. In the case of raw materials, notified by the government as coming under the IPRS, the difference between the international price as notified by the government, and the domestic price, is reimbursed to the exporters.

3) Cash Compensatory Support (CCS)

This scheme was in existence till 1 July, 1991. This provided cash payment to exporters at a predetermined percentage on the FOB value of exports. When the rupee was devalued in the 1st week of July 1991, this incentive was removed.

4) Drawback of Duties

In the manufacture of many export products, there is a substantial element of customs Duty paid on imported components, as well as excise duty on the indigenous purchases. These are evaluated on a yearly basis,

and the exact quantum of this drawback duties is published by the Ministry of Finance. Accordingly, they are refunded to the exporter after the completion of the export.

5) Marketing Development Fund (MDF)

This came into being in 1963-64. The nomenclature was changed to Marketing Development Assistance (MDA) in 1975. The fund is administered for providing grants/assistance to Export Promotion Councils, other export bodies, also for special schemes approved for specific export promotion efforts.

The fund is on the decline, and sufficient amount has not been set apart in recent years.

6) Fiscal Benefit

In order to promote exports and enable the exporters to plough back into the export trade, their profits for higher exports, government has exempted export profits from tax under 80 HHC provisions of the IT Act.

In the case of an exporter who is engaged in the sale of goods, both in the export and domestic market, the proportion of profit is taken in the same ratio of the export turnover to total turnover.

7) Finance Facilities

Credit facilities are made available to exporters for purchase, manufacture and packaging prior to shipment, as also post shipment

credit facilities. Medium and long term credits are also made available for the export of capital equipment. The government helps the banks to keep the interest rate on exports much lower than the domestic interest rates.

8) Excise exemption Facilities

Various goods, either in the finished form or as they are being used in the manufacture of certain products, are liable to payment of excise duty under the Excise & Salt Act, 1944.

Goods exported out of the country are, however, given the facility of obtaining a refund of such payments, which may be had after paying the duty by exporting under bond.

Most of the firms prefer executing a bond with the Excise Authorities, so that goods may be cleared without payment of duty, thus avoiding a lock-up funds.

9) Bilateral Agreement

Since independence, India has entered into trade agreements with many countries. These agreements are bilateral in the sense that they are between two parties, but do not necessarily commit each party to export or import specific quantities of commodities covered by the agreements. In some cases a ceiling for certain commodity heads is given. This ceiling is based upon the country's ability to supply and also on the balance of trade between the two countries.

These trade agreements also provide for certain arrangements in respect of mode of payment for imports. In some cases, the mode of payment is in Indian Rupees, which are called "Rupee Payment Agreements". There is always some misunderstanding about the implications of payment when mentioned in Indian Rupees. All the payments made to foreign countries in India Rupees are, in the final analysis, payments in foreign exchange. Even when Rupees are not directly converted into a foreign currency, they are utilised by the foreign buyer for financing export from India or for availing of services in India, for both of which he would have normally remitted foreign exchange. In other words in all such cases, the foreign exchange that would otherwise have been earned by exports or service, is lost to the country. Thus, though at first the transaction takes place in Indian Rupees, the final result is that India pays for the goods and services supplied by the foreign party in foreign exchange.

Of these agreements, some of the important ones were with the East European Countries. The importance of these were due to the fact that we had bilateral clearing arrangements which envisaged a balanced trade in non-convertible Indian Rupees with the erstwhile USSR, Czechoslovakia, Rumania, Hungary and Bulgaria. This has in the past helped India in converting free foreign exchange for importing essential and critical items like petroleum products, fertilizers, news print, sulphur, non-ferrous

metal etc. On a rupee payment basis. It has also helped to diversify our exports to these countries and balance the trade by substantial exports from India on a rupee basis.

The recent political and economic changes in East Europe, and the establishment of a market economy in these countries are affecting the very basis of such bilateral arrangements. Trade with Hungary and Bulgaria is being conducted on the basis of free foreign exchange, and trade with Poland also has been converted to free foreign exchange basis from 1st Jan., 1991. Such arrangements with other countries especially the former Soviet Union Which has now been transformed into a group of countries known as Common wealth of Independent States (CIS) are undergoing many changes. India is trying to negotiate with each state such as Russia, Ukraine, Tadzhikistan, etc. Independently in order to arrive at separate bilateral agreements.

Infrastructural Set-up and Aids

i) Export Promotion Councils

A number of export promotion councils have been established, mainly with a view to assisting in the promotion of exports of specific commodities or groups of products. Great stress is also laid on creating export consciousness among potential exporters. These councils are registered as non-profit organisation under the Companies Act. A list of these councils is given in Table 5.5.

Table 5.5 List of Export Promotion Councils

- 1) The Basic Chemicals, Pharmaceuticals and Soap Export Promotion Council, Bombay - 1.
- 2) The Cashew Export Promotion Council, Cochin - 6.
- 3) The chemicals and Allied Products Export Promotion Council, Calcutta - 1.
- 4) The cotton Textile Export Promotion Council, Bombay - 1
- 5) The Engineering export Promotion Council, Bombay - 8
- 6) The Export Promotion Council Finished Leather and Leather Manufactures Kanpur - 1.
- 7) The Gem & Jewellery Export Promotion Council, Bombay 34.
- 8) The Handloom Export Promotion Council, Madras - 6.
- 9) The Leather Export Promotion Council, Madras - 3.
- 10) The Marine Products Export Promotion Council, Bombay 025.
- 11) The Plastic & Linoleum Export Promotion Council, Bombay 25.
- 12) The Processed Foods Export Promotion Council, New Delhi 1.
- 13) Shellac Export Promotion Council, Calcutta - 1
- 14) The Silk & Rayon Export Promotion Council, Bombay - 1
- 15) The Spices Export Promotion Council, Cochin - 16.
- 16) The Sports Goods Export Promotion Council, Cochin - 16.
- 17) The Tobacco Export Promotion Council, Guntur, A.P.
- 18) The Wool & woollens Export Promotion Council, Bombay - 20.

All these exporters of products coming under the council are entitled to become members of the council. The members are charged an annual subscription fees for the services rendered by the council. Special low subscription fees are charged for small scale industries.

The members of the council, by a suitable voting system, elect a Working Committee, which in turn elects a chairman and other office-bearers. All problems and policies relating to the export of the products coming under the council are discussed by the Working Committee, and necessary action taken.

The government provides grants under specific heads for these councils, and also appoints senior officials to act on the Working Committee and guide its deliberations.

It is imperative for exporters to be registered under the council concerned, if they want to claim export incentive and assistance as per the policy of the government.

The main functions of the councils are.

- a) To assist exporters in a proper understanding, interpretation and implementation of the export policies and assistance schemes formulated by the government.
- b) To aid in export promotional activities such as internal and external publicity, participation in exhibitions and trade fairs, promotion of exclusive exhibition of specific commodities / products etc.

- c) To arrange in an organised manner, trade delegations, to be sent to one or more countries to promote the export of specific products or a group of products, and to circulate the reports of such visits to exporters to help their export activities.
- d) To carry on an effective liaison with industry and trade in order to identify the problems faced by them in their export activities, so that they can be taken up with government and solution found.
- e) Arrange to collect complete data on export with the problems faced by exporters, the specific help needed by different product manufacturers, and present the same to the government in order to enable it to evolve policies to sustain and improve exports in the right direction.
- f) After identifying the areas where there is the need and potential for growth of exports, to open foreign offices to help exporters in consolidating the existing exports and diversifying to new products. This is very useful for small manufacturers who are unable to make trips personally, or keep in touch with buyers abroad, and need assistance of this nature.

II) Commodity Boards

The Government of India has set up eight commodity boards, the objectives of which are to guide the production and exports of the respective commodities along the right lines.

1) Coffee Board

The Board was set-up under the Coffee Act of 1942 for the development of the industry and the promotion of its exports. The board has set up a Central Coffee Research of its research activities are made available to coffee growers. The Board inserts special advertisements in foreign trade journals and mass circulation newspaper media. Further, it takes part in trade fairs and exhibitions to further the export of the product.

2) Tea Board

This was set-up by the Government of India under the Tea Act of 1955, the main objectives of which are the development of the tea industry and the promotion of its exports. The Board has set-up offices in India as well as abroad. It is also associated with the Tea Councils set-up in the UK, the USA, W.Germany, France, Australia, New Zealand and Canada with the co-operation of other tea-producing countries. The Board also arranges for quality control and pre-shipment inspection wherever necessary under the Tea Control Order of 1959.

3) Cardamom Board

The Board was constituted under the cardamom Act of 1965 by the Government of India as a statutory body with its headquarter at Ernakulam in Kerala State. It has a foreign office at Brussels, which co-ordinates the exhibitions organised abroad and undertakes promotional campaigns.

4) Rubber Board

This is also a statutory body set-up by the Government of India under the Rubber Act of 1947. The Board advises Government on all aspects of the rubber industry, and controls the planning, marketing and acquisition of rubber. One of the important functions of the Board is to promote the development of the rubber industry in India. It deals with the registrations of estates, issue of new planting and replanting licences, and other development schemes such as replanting subsidy. It has a Rubber Research Institute with well-equipped laboratories and many publications for the benefit of the industry.

5) Coir Board

This was set-up in 1953 under the coir Industry Act for the development of the coir industry. It has a coir Research Institute at Alleppey, as also a national coir Training and Design Centre. It carries out research surveys, encourages new coir establishments and engages expert weavers to give practical training to the trainees. It undertakes publicity in India and abroad, through mass media and exhibitions.

6) Central Silk Board

The Central Silk Board was constituted in 1949 under the Central Silk Board Act. The board undertakes (1) The development of the sericulture industry (b) the implementation of annual plans and

achievement of production and export targets, (c) the organisation of research, training seed production and d) the import-export of raw silk fabrics. Its head quarter is located in Bombay, and runs the following establishments.

The Central Sericulture Research Stations Berhampur, Kalimpong, Mysore and Ranchi, and

Central Silkworm seed stations in Pampore, Lakha and Coonoor.

7) The All-India Handicrafts Board

The Board, having its headquarter in delhi, undertakes.

- a) The running of four design centers at Bombay, Calcutta, Bangalore and New Delhi, and one development center at Bangalore.
- b) To help state governments in the planning and execution of development schemes.
- c) The development and evolution of new designs which are commercially viable, and production of proto-type, and
- d) Export promotion measures such as participation in trade fairs and exhibitions, production of films, brochures, catalogues and other promotional aids.

8) All-India Handloom Board

The Board is doing vigorous work in spreading this cottage industry. There are two institutes of Handloom Technology one at Salem and the other at Varanasi. They conduct diploma courses of three years, on

successful completion of which students are awarded a Diploma by the Board.

The Board Conducts seven weaver centers located Bombay, Indore, Varanasi, Calcutta, Mangalagiri, Bangalore, and Madras. These Centres carry out research with a view to evolving new and attractive designs for internal and export markets. They also render technical assistance to the internal and export markets. They also render technical assistance to the internal and export markets. They also render technical assistance to the handloom industry in the fields, of printing, dyeing and weaving. Further, they provide financial assistance and other help to the industry by organising depots abroad and aid in arranging preshipment, quality control inspection.

Apart from the above, the Office of the Jute Commissioner, established by the Government of India, renders all possible assistance to the industry and Government in the promotion of export of jute. Similarly, the Office of the textile commissioner looks after the export promotion of textiles and their derivatives.

iii) The Board of Trade

The Board was constituted in 1962. The main function of the board is to discuss all the problems pertaining to the export trade of the country. For this purpose, it meets periodically. The government is contemplating a new body in place of the Board of India.

It consist of senior officials of the Economic Ministries of the Government of India, leading representatives of organised trade and industry, and economists of repute. It is chaired by the Minister of Commerce. The Secretary to the Ministry is the Vice Chairman of The Board.

The Board concentrates on such areas as.

- (i) Expansion of export -oriented production and increases of exportable surplus, and
- (ii) The improvement of the infrastructure required for substantial exports.

iv) Advisory Council of Trade

This was constituted in January 1970. Its membership consists of Members of Parliament, the Reserve Bank of India. Export Credit & Guarantee Corporation, Commodity Boards, Export Promotion Councils, public sector trading organisations and other commercial and industrial organisations. The council continues to meet annually, reviews the exports of the country, import - export trade regulations trade controls, export marketing and assistance, and makes its recommendation for the furtherance of exports.

(v) Zonal Export-Import Advisory Committee

There are four such Zonal Committees functioning in New Delhi, Bombay, Calcutta and Madras. A prominent businessman is appointed as Chairman of these Zonal/Regional Advisory Committees and the Joint Chief Control of Imports & Exports is the Member Secretary. All interests of trade, industry, customs, excise, port Trust, etc. are included in the

Zonal Committee, which meets three to four times a year and deals with all zonal problems faced by the exporters, such as.

- (i) Import licensing and clearance.
- (ii) drawback payment
- (iii) pre-shipment inspection
- (iv) export incentives
- (iv) Port Trust and shipping problems: and evolves methods/ simplified procedures for a smooth functioning of the system.

VI) Chambers of Commerce & Industry and Associations of Trade & Industry.

These play a prominent role in the export promotion activities of trade and industry. They arrange periodic meetings which help in.

- a) an exchange of information and compilation of data, indicating the present state of the export activities in a particular trade/industry.
- b) an exchange of views and formulations of specific remedies policies which will be taken up with the government.

Membership of the Chambers and Association is open to all members of Trade and industry. The discussions therein are amongst professional people who have a through knowledge of a trade or an industry. This can be an excellent forum to project practical, viable and sound

suggestions for removing impediments or changing policies in the national interest, provided the right persons are chosen at the helm.

Many of these Chambers/Associations have separate sections/cells to deal with the export trade which are helpful in interpreting Government policies to members, disseminating data to them and also in making meaningful representation to government.

:vii) The Trade Development Authority (TDA)

The TDA was set-up by the Government of India in 1971 in pursuance of the export policy resolution adopted by the parliament.

The important objective of TDA was the promotion of selective and intensive development of products with growth potential by technically and commercially viable units, by providing a package of services in the field of export production, marketing and in the elimination of procedural delays.

In its development the TDA has laid greater emphasis on specific buyers for specific products in selected markets. It has identified a large number of buyers and import houses in USA, Canada, the UK and Western Europe who are brought into contact with specific exports.

It has identified eighteen product groups, comprising about 150 items for intensive export development and also for rendering its package assistance to them.

The product groups are.

- 1) Electronic equipment and components.
- 2) Sewing machines and components.
- 3) Bicycles and components
- 4) Automobile ancillaries
- 5) Industrial fasteners
- 6) Ferrous castings and forgings for industrial application
- 7) Stainless steel cutlery
- 8) Thermoplastic and thermostatic plastic goods.
- 9) Small tools and hand tools.
- 10) Instruments for industrial laboratory, hospital and education use.
- 11) Processed fruits, juices and vegetable products.
- 12) Modern furniture, including dimension stocks for CKD furniture
- 13) Leather goods and garments.
- 14) Selected consumer goods like ready-made garments, knitwear, etc.
- 15) Selected handicrafts like art metalwares and wooden articles
- 16) Sports goods.
- 17) Agarbathis
- 18) Locks and padlocks.

The package servicing plan of the TDA helps mainly the following fields.

- a) Selected raw materials, import licenses for inputs, machinery etc. can be routed through the TDA, which will obtain them expeditiously
- b) Priority consideration for an application for machinery on hire-purchase basis to the National Small-Scale Industries Corporation will be accorded when sponsored through the TDA.
- e) Quick release of foreign exchange for travel.
- d) The TDA helps exporters in the quick establishment of duty drawback and realisation there of.

The TDA helps exporters in the quick establishment of duty drawback and realisation there of.

The TDA service is available only to its clients who according to the TDA, are technically and commercially viable units. The membership fee is Rs.2,000 per annum for units in medium and large-scale industries and Rs.500 per annum for small-scale industries.

The TDA was at a time when exporters used to spend a great deal of their time and energy in obtaining raw materials, licences and foreign exchange for travel abroad. Since then, however, regulations have been liberalised to enable them to avail themselves of facilities with the least possible delay. Though more than fifteen years have passed since the TDA came into being, the time has come for an independent and objective assessment of its cost/benefit analysis. Government has merged TDA with the Trade Fair Authority of India on 1.1.92.

(viii) The Federation of Indian Export Organisations (FIEO)

The FIEO is a non-profit servicing organisation and is registered under the Societies Registration Act. It is an apex coordinating agency dealing particularly with problems of a general nature, common to all commodities. It also deals with those commodities and services for which there is no specific export promotion council or commodity board.

There are eight commodity boards and eighteen export promotion councils, each of which offers the exporters specific services in their particular products. There are also Export Credit & Guarantee Corporation, the Industrial Development Bank of India, the Reserve Bank of India and other scheduled banks, the Institute of Foreign Trade, etc., all of which play important roles in export promotion. Further, there are Associations of Industry and Trade and Chambers of Commerce. The FIEO provides a very good forum for all these bodies to come together and project the needs of the exporting community as a whole. It also helps in collecting and forwarding all important commercial and market information to its members, sends trade delegates abroad to specific countries, and invites foreign delegations.

FIEO also pays special attention to the development and needs of the export houses and consultancy firms which have come to play major roles in substantially increasing our exports.

(ix) Export Processing Zone

It is a well-known fact that labour charges in developed countries have increased substantially, and that therefore, the cost of production

involving a considerable labour content has in these countries become uncompetitive in these countries. Consequently, they prefer to send raw materials and components to a developing country where trained manpower and skill are available at a comparatively low cost so that they may have finished products which they can market at competitive prices.

In order that advantage may be taken of such export opportunities where the country gains foreign exchange to the extent of conversion costs, in such manufacturing, "export processing zones" have been established, which also help to increase the employment potential. For progressive units, moreover, these export processing zones provide the added advantage of new technology and technical know-how, which are of considerable use and benefit in the domestic economy.

Two examples of such activity in India are:

- a) The Kandla Free Trade Zone; and
- b) The Santa Cruz Electronic Processing Zone

All the facilities that are needed for the setting up of export industries - developed land, water, electricity, transport requirements (road and rail), etc-are provided by the administration to prospective entrepreneurs. Further, procedures have been simplified with a view to getting complete exemption from customs duty on imported raw materials and components, as also other export procedures, so that production and delivery schedules may be easily kept.

The Government has appointed special committees which clear the needs of entrepreneurs for all their requirements, such as advance licences, special exemptions and various other needs which may arise in their manufacturing establishments.

(x) Indian Institute of Foreign Trade.

In the earlier days before independence, exports from India were of a captive nature, mainly directly towards Britain at prices and on terms which suited the colonial power. Since independence, however, the export of primary products, or traditional exports as they called continued on a set pattern.

When the need for exports obviously increased, diversification to non-traditional exports and sophisticated items was resorted to. Having become broad-based, the industrial infrastructure helped in the export of non-traditional and sophisticated items. It is at this stage of switching over to non-traditional items, which was inevitable, that India experienced a dearth of trained and skilled personnel so essential for the development of the export trade.

The Indian Institute of Foreign Trade was set-up in 1963 as an autonomous body registered under the Societies Registration Act. The main function envisaged for the Institute are.

- a) Training of personnel in export trade.
 - b) Research projects in furtherance of exports, and
 - c) Collection of documents and data on all aspect of export trade.
- a) Training. The Institute conducts training programmes on various aspects of export trade. Broadly, these fall into three categories, tailored to various needs.
- 1) Programmes, for senior export marketing executives and governments personnel of India and various developing

Countries

- 2) Programmes for junior executives and fresh graduates, and
- 3) Special training programmes on the basis of requests from various organisations developed to suit their needs.

b) **Research.** The research activities of the institute are confined to export trade-mainly in the field of policy formulation and in the field of specific exports, market surveys etc.

Another area in which the Institute has successfully forged ahead is in the field of surveys conduct by it on behalf 9 of the various State Governments to identify commodities from each State which have an export potential. A perusal of these surveys for export from a state (b) investigates the problem faced by such industry in exports (c) studies export marketing problems for such products and finally, (d) makes recommendations as to the type of assistance needed for such industry and also indicated various other industries which can be established on the basis of their export potential arising out of the availability on the basis of the raw materials and other expertise in the State.

The Institute, moreover, has an excellent reference library where, apart from publications of such international organisations as GATT, UNCTAD, UNO, etc. It has a wide range of publications and periodicals on all aspects of the export trade.

(xi) Export Inspection Council

This council came into being mainly to ensure that quality standards of export products are maintained-an essential in the export trade. As long as quality is maintained by the exporter, he will

continue to get repeat orders from abroad and may also hope to get progressively higher prices. But if, due to any slackness on his part, one shipment carries substandard goods which are not accepted by the buyer, not only will he lose his market and reputation, but will also damage the image of the country as a whole. Hence, in this context, the establishment of the Export Inspection Council to help exporters to set-up and maintain high standards and quality control on the export merchandises was a welcome feature.

The Export (Quality Control & Inspection) Act came into being in 1964. Under this Act, the Government of India notifies products which will be subject to compulsory quality control or inspection or both before shipment. The products which are covered by this Act can be exported only after a certificate for this purpose has been obtained from a recognised agency, indicating that they conform to approved specifications.

Under the Act of 1964, the Export Inspection Council was set up by the Government of India. The Council consults industry and trade, holds detailed discussions with them as also organisations like Export Promotion Councils, Commodity Boards, Indian Standards Institutions and such other technical institutions, and studies buyer's needs before formulating standards for a pre-shipment inspection of export products.

Recently, after a decade of experience in the field, the EIC has come out with new schemes, such as declaring certain manufacturing organisations, which have their own quality control system, as export-worthy. It has also decided to have a new scheme of self-certi-

fication, according to which these organisations will be given the authority to issue their own certificates of quality which will be accepted subject to certain rules and regulations to be formulated by the council.

The Export Inspection Council has set up five export inspection agencies, one each at Delhi, Bombay, Calcutta, Madras and Cochin. These have been staffed with competent technical control of the Council and attend to the inspection and certification of the products falling under the Act.

(xii) Indian Council of Arbitration

In export trade, sometimes a dispute arises between a buyer and seller in which the buyer complains that the seller has not fulfilled the conditions of the contract. These may be due to (a) quality (b) quantity, (c) delivery (d) packing, (e) specifications, and (f) price or due to any other conditions of the contract. In such cases, arbitration becomes necessary—a procedure which should be acceptable to both the parties.

The Government of India established the Indian Council of Arbitration in 1965, which is registered under the Societies Registration Act as a non-profit organisations.

The main objectives of the Council are:

- a) To publish literature on commercial arbitration cases and allied literature.
- b) To conduct meetings and seminars to acquaint exporters with international law and commercial arbitration.
- c) To render advisory services to the export community with

regard to arbitration clauses and allied matters which have to be included in international trade contracts and

- d) To help in the settlement of trade complaints, by providing services for settlement of business disputes by arbitration. For this purpose, the Council maintains a panel of arbitrators.

As is normal in such cases, the help of the Council may be invoked only when there is an arbitration clause in the contract or, in the alternative, when both the parties to the dispute agree to refer the matter to the council.

The conciliation services of the council are rendered free of charge. However, in cases of arbitration, fees charged the Council are nominal. The arbitration proceedings of the Council are governed by the rules of arbitration, which can be obtained from the council.

(xiii) Exhibitions and Commercial Publicity

The traditional export products from India, such as tea, jute, etc., are fairly well known abroad. However, regarding the nontraditional products, there is not sufficient awareness, and in some cases, no awareness at all. It is therefore, essential to bridge the information gap about our country's industrial progress and export capability. These have been done through all the available media, such as trade fairs and exhibitions, literature radio and TV, and documentary films.

The government has constituted the Trade Fair Authority of India (TFAI) to concentrate exclusively on fairs and exhibitions in furtherance of

international trade. Its main functions are.

- a) Organising India's participation in industrial trade fairs and exhibitions
- b) Organising exclusive Indian exhibitions abroad.
- c) Organising international trade fairs in India.

Trade fairs and exhibitions which offer good prospects for the export of Indian goods are selected. This method of export promotion has, assumed great importance as all countries use it as an effective means of getting entry into export markets.

The publications of the Trade Fair Authority of India which will be of considerable interest to trade and industry are.

- 1) Economic and Commercial News-a weekly
- 2) The Journal of the Industry and Trade-a monthly publication, highlighting industries and industrial products which project the image of India's explorable merchandise in foreign markets.
- 3) India Export Bulletin-a fortnightly publication, containing mainly information on global tenders, trade enquiries of specific products from abroad and various other export opportunities, trade regulations, etc. TFAI and TDA are merged with effect from 1.1 1992 and made into a single organisation.

(xiv) State Trading Corporation of India (STC)

The STC, a public sector agency, was set up in 1956 as an autonomous corporation to play an important role in implementing the

Government's foreign trade policy. The main functions of the STC are

- 1) Diversifications of, and consequently increases in, India's export trade.
- 2) Exploring of new markets for existing as well as new products, and
- 3) Promotion of long-term export operations and 'difficult to sell' items.

The STC is also entrusted with products/ product-groups, the export of which is canalised through it. Similarly, imports of a lot of items are canalised through the STC. Hence, the activities of STC encompasses exports, imports and domestic trade.

It has also set up the Industrial Raw Material Assistance Centre which imports raw material in bulk and distributes them to industry "off the shelf" at competitive prices. The objective is to extend the benefit of bulk buying to actual users in non-canalised items.

The STC had, moreover, undertaken price support operations at the instance of the Government of India for natural rubber in 1970 and for tobacco in 1972. Growers were assured of remunerative prices, and surplus quantities mopped up by the STC, were exported.

The export earnings of STC in 1988-89 was Rs. 531 crores as against Rs. 581 crores in 1987-88. The import sales of STC fell from Rs. 3037 crores in 1987-88 to Rs. 2036 crores in 1988-89. Consequently, the total turnover of STC of Rs. 2586 crores in 1988-89 was lower than the previous year's turnover of Rs. 3646 crores. The decline

is primarily attributed to the decline in the import of edible oils.

(a) The Projects and Equipment Corporation of India (PEC)

The PEC was formed in April 1971 as a wholly-owned subsidiary of STC. It took over the Railway Equipment and Engineering Division of the STC. The main objectives of forming the corporations were (1) to boost the export of engineering and railway equipment in established markets (2) to penetrate new markets, (3) to promote the export of non-traditional and new products and (4) to boost the exports of turnkey projects in the field of railway systems, public utilities and industrial plants.

Some of the products in which the PEC have negotiated and signed contracts are:

Railway Wagons and Coaches, Steam and Diesel Locals, Electrical Equipments, Garage Equipments, Pumps and Compressors, Auto Components, Hand Tools, Textile Machinery, Cycle and Cycle parts, etc.

b) Cashew Corporation of India.

This was incorporated in 1970 as a wholly-owned subsidiary of the STC. The main objectives of the corporation are.

- 1) To find new markets for the export of cashew kernels.
- 2) To establish new sources of the import of raw cashes-nuts, and
- 3) To ensure and uninterrupted supply of imported raw cashew nuts at fair prices for export oriented industries.

It may be pointed out that the cashew industry is heavily depend-

ent on imported raw cashew nuts. In order to overcome fierce and unhealthy competition among importers, and also to get the benefit of economic prices on large-scale purchases, canalisation of this industry was brought about.

c) Handicraft and Handloom Export Corporation of India.

The Handicrafts and Handloom Export Corporation of India came into existence in 1962. It is a subsidiary company of the State Trading Corporation. The main objective of the corporation is to develop new markets and expand traditional ones thus supplementing and aiding the existing private sector trade in handloom and handicrafts.

During the earlier years, by and large, the sale of Indian products was primarily a cheap curio type of sales. There was no organised effort to export highly sophisticated products which would show the craftsmanship and heritage of our country. One of the important functions of the Corporation was to project a good image of India's craftsmanship abroad. In order to achieve this, the corporation set up showrooms in New York, Boston, Montreal, Paris and Nairobi and also their famous "SONA" retail outlets to offer the public a wide range and variety of handicraft products not normally marketed and available in those countries.

The HHEC also studies consumer preferences abroad and introduces new products with special emphasis on the excellent craftsmanship of India. It further helps the trade by means of advice and market exposure, and also by providing finance in the form of loan. It participate in trade fairs and exhibitions abroad, which in many

cases, gives foreign countries a first hand idea of the variety and range of Indian handicraft products. It also encourages delegates from abroad, consisting of important buyers representing large chain stores, to visit this country, study the products and offer valuable suggestions for improvement also arrange for big long-term purchases from India.

(xv) The Minerals and Metals Trading Corporation

This corporation, known as the MMTC, was established by the Government of India in 1963. It was expected to develop the export of mineral ores and such other products as are assigned to it by the government from time to time. It was also given the responsibility of importing some essential raw materials for Indian industries.

Of all main products, it concentrated on the export of iron ore, manganese ore, certain grades of coke and coal, ferro-manganese, bauxite, etc. Iron ore occupies a predominant position in this exports. The total exports of the country in iron ore and concentrates are of the orders of 28 million tonnes, fetching foreign exchange earnings of Rs. 543 crores in 1988-89. It should be borne in mind that MMTC is responsible only for the export of iron ore other than ore of Goan origin.

On the import side, the corporation buys non-ferrous metals, fertilisers, certain categories of steel, etc., in bulk quantities at competitive rates for supply to Indian Industries.

The various subsidiaries of STC and MMTC were established and expanded with the avowed Government objectives of placing the export and import trade, especially of the products which come under

the purview of these organisations, in the public sector with a view to giving a boost to export trade. However, the performance of these corporations has not come up to the levels of export trade expected of them.

(xvi) Export Houses and Trading Houses

The origin of Export House in India goes back to 1958, when government gave serious consideration to the development of specialised agencies for the promotion of non-traditional items. This was mainly because the international areas consisted of highly experienced and resourceful trading houses and unless a positive step was taken to build up a number of merchant houses, concentrating exclusively on exports and developing the various special skills and the expertise therein, it would be impossible to succeed against international giants. Further, such a step was expected to help the small-scale sector considerably in the export of its products.

The governments evolved the criteria for the recognition of export houses in 1960, and again revised it in 1965 and 1968. The Policy of the export houses was under constant review.

The criteria adopted by the government in the export import policy of 1985-88 for recognition as an Export House were.

The exports were divided into select product (these were non traditional items like engineering goods, leather products, etc) and non-select products (these were traditional items). For qualifying as an export house, the exports in the select list of products or non-

select list of products should not be less than Rs. 3 crores and Rs. 7 crores respectively. These limits were suitably reduced in the case of small-scale sector export houses.

Such recognised export houses were expected to show a minimum average annual growth rate of at least 20% in the prescribed base period or in the immediately preceding year, as compared to the preceding three years.

The main extra facilities provided to such export houses were certain additional licenses to them to enable them to help the supporting manufacturers, and also transfer them to others on a consideration so as to meet the competition in the export market.

The concept of Trading Houses in India was brought into being by the government in 1981-82. It was in line with such a concept in the developed countries, where encouragement was given to those organisation who have professional expertise in the field of exports and international trade, to enlarge their base and help increase the exports of the country by developing new products for new markets, as also the small-scale sector.

In order to encourage Trading Houses which have increased their exports substantially and had a tremendous potential, government brought in the concept of Star Trading House in addition to Export House and Trading House.

The criteria for an export organisation to be recognised as Export House or Trading House were as follows. until March, 1992, the net foreign exchange earnings should be Rs. 4 crores in the case of Export House and Rs. 75 crores in the case of Star Trading Houses. The main benefits which acquired to these organised institutions were the provision of special additional import licences and various other liberalisations in the utilisation of such licences.

With effect from 1st April, 1992, the criteria for recognition as Export House, Trading House or Star Trading House are the Net Foreign Exchange (NFE) earning either on an average annual basis in the last 3 year or in the single preceding year as indicated below.

Category	Average NFE in Rs. during base period, i.e. preceding 3 licensing years	NFE Rs. during base period, i.e. preceding licensing years
Export House	3 crores	12 crores
Trading House	30 crores	60 crores
Star Trading House	125 crores	150 crores

The NEC is calculated on the following basis.

The FOB value of the exports made by the exporter is taken, and deducting therefrom

- a) the CIF value of all goods (other than capital goods) imported by him
- b) the CIF value of all goods (other than capital goods)

imported in the name of or through an associate or supporting manufacturer, and

- c) the value of all payments made in foreign exchange by the exporter by way of commission, royalty, fees or any other charges.

The additional benefit to Export House, Trading House, Star Trading House.

(1) NEF earned by the export of products manufactured by SSI and handicrafts sectors respectively and routed through an Export or Trading House, will be given double and triple weightage. Handicraft products will include silk products also.

(2) Export House/Trading House/Star Trading Houses shall be entitled to special import licences for such value or bearing such proportion to the NFE earned during in the previous licensing year for the import of such items included in the Negative list of imports as may be specified.

The validity period of Export House/Trading House/Star Trading House certificates is for three years ending 31 march of the licensing year provided the criteria are met

(XVII) Free Trade Zones

Time concept of Free Trade Zones has been in existence for a long time. They are very popular and successful in the newly industrialised developing countries of the Far East. India entered this arena with the establishment of Kandla Free Trade Zone in Gujarat and later Santa Cruz

Electronic Export Processing Zone (SEEPZ) in Bombay.

The government selects a large area of land, preferably close to a port, provides the infrastructure, such as land, water, electricity, and standard construction if necessary for units to be established within the zone. The main facility afforded, to these units are duty free imports of capital goods, raw materials, ancillaries, etc. for manufacture and export.

The goods manufactured in the zone can also be supplied to the domestic market up to 25% of the production against valid import licences.

The following were the exports from the Free Trade Zones in 1990-91

	Rs. Crores
(a) Kandla Free Trade one	456
(b) The Santa Cruz Electronic Export Processing Zone	368
(c) NOIDA (New Delhi) Export Processing zone	45
(d) Madras Export processing Zone	61
(e) Falta (West Benga) Export Processing Zone	25
(f) Cochin Export Processing Zone	6

(xviii) 100% Export-Oriented Units

The scheme of 100% EOUs was introduced in 1980 with a view to generating additional production capacity for exports by providing an appropriate policy framework, flexibility of operations and incentives. In order to enable them to operate successfully in the international market ,

such units are allowed to import machinery, raw material, components and consumables free of customs duties. And if produced indigenously full remission of excise duty is available. Three units have to operate under custom bond and achieve the level of value addition fixed by the Board of Approval.

193 units have reported commencement of production and the cumulative exports from 1005 EOUs by the end of March, 1991 have amounted to about Rs. 3230 crores. Export performance of these during the last 5 years has been as follows.

Years		Rs. Crores
1986-87		291
1987-88		245
1988-89		460
1989-90		605
1990-91	(provisional)	640
1991-92	(provisional)	563
(up to Dec. 91)		

The working of both the schemes is reviewed from time to time through interaction with the units, with the view not only of resolving problems of individual units, but also to effect further improvements where required.

Some of the recent modification of the 100% EOU/EPZ are as follows.

- (1) Automatic approval is given for new units by the Development Commissioner of the Zone to those who fulfill the minimum specified conditions.
- (2) The duty applicable to domestic sales from EOU/EPZ has been reduced by 50%
- (3) The Scheme of International Price Reimbursement (IPRS) for Iron and Steel has been extended to them.

The latest and most significant change has been brought about in April 1992 when government announced that all the export realisation of 100% EOU can be on the market determined exchange rates.

Problems

In spite of these facilities, concessions, and incentives our exports continue to lag behind our imports. Reasons can easily be found.

- 1) We face shortage of almost all products in the domestic market. When supply is not adequate to meet domestic demand, exports become meaningless. Often, we curbed domestic demand and exported certain items, just to earn foreign exchange. Classic example is sugar.
- 2) Productivity in our industrial establishments has been very low. Low productivity led to high cost of production. This made our products less competitive in the international market.
- 3) Lack of adequate transport, particularly shipping, hampers export possibilities. As was pointed out earlier, we have lost

almost \$ 1 billion owing to lack of direct shipping link with china.

- 4) Goods made in India have not gained acceptance world wide. Quality is poor, prices are high, packing is shabby and delay in execution of order is not tolerable. We are able to sell mainly in the least developed countries (our exports to LDCs amount to 25 percent, see table 26.4). Developed countries are lukewarm in their response to our products.
5. The so called export-promotion measures have failed in their objectives. Take the case of 100 per cent export oriented units, for example. The scheme was launched with much fanfare in 1981 and bolstered time and again with the help of a variety of concessions. But the scheme failed to take off. Although, 569 units were given approvals since inception, only 99 have commenced production. In the five year period (1981-85), the total foreign exchange earned by the was a meagre Rs.355 cr. as against the target of Rs. 5,000 cr. Those that were set up have virtually become 100 percent import-oriented units, instead of functioning as 100 per cent export oriented units.

New Initiative

Government has recently set a target of tripling the export earnings by the turn of the century. Towards this direction, the government has identified 15 products and 15 countries (see table 26.6) where the

country has competitive advantage. The thrust of the new initiative is to take advantage of our strength.

Table 5.6. India's Top Export Markets

Rank	To markets	Top markets
1.	U.S.	Gems and Jewellery
2.	Japan	Cotton and accessories
3.	Germany	Cotton yarn, fabrics and made-ups
4.	U.K.	Marine products
5.	Hong Kong	Drugs and pharmaceuticals
6.	U.A.E	Transport equipment
7.	Belgium	Metal manufactures
8.	Italy	Machinery and instruments
9.	Russia	Leather manufactures
10.	Singapore	Man-made yarn, fabrics and made-ups
11.	Bangladesh	Oil meal
12.	The Netherlands	Leather footwear
13.	France	Dyes, intermediaries, etc.
14.	Saudi Arabia	Plastic and linoleum
15.	Thailand	Readymade goods and manmade fibres.

(Source: Business World, 10-23, Jan, 1996)

QUESTIONS

1. Bring out the role of exports in our economy. List the various measures undertaken to promote exports.
2. Trace the reasons why our imports continue to exceed exports.
3. What are export strategies ? Which strategy is suitable to India ? Why ?
4. Draft a model market survey report along with a questionnaire.

1. Discuss the role of exports in the economy. List the various measures undertaken to promote exports.
2. Discuss the reasons why our exports continue to remain low.
3. What are the major factors which contribute to the low level of exports?
4. Discuss the role of exports in the economy with a diagram.

1	Exports	Exports are goods and services sent out of the country.
2	Imports	Imports are goods and services brought into the country.
3	Balance of Trade	Balance of Trade is the difference between exports and imports.
4	Trade Deficit	Trade Deficit occurs when imports exceed exports.
5	Trade Surplus	Trade Surplus occurs when exports exceed imports.
6	Export Promotion	Export Promotion refers to measures taken to increase exports.
7	Export Subsidy	Export Subsidy is a financial aid given to exporters.
8	Export Credit	Export Credit is a loan provided to exporters.
9	Export Insurance	Export Insurance is a policy taken to protect exporters from risks.
10	Export Control	Export Control refers to measures taken to regulate exports.
11	Export Restriction	Export Restriction is a measure to limit the quantity of exports.
12	Export Tax	Export Tax is a tax levied on exports.
13	Export Duty	Export Duty is a tax levied on exports.
14	Export License	Export License is a permit issued to exporters.
15	Export Certificate	Export Certificate is a document issued to exporters.
16	Export Bill of Lading	Export Bill of Lading is a document issued to exporters.
17	Export Invoice	Export Invoice is a document issued to exporters.
18	Export Packing Slip	Export Packing Slip is a document issued to exporters.
19	Export Certificate of Origin	Export Certificate of Origin is a document issued to exporters.
20	Export Certificate of Conformity	Export Certificate of Conformity is a document issued to exporters.