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Exam Code : ESM

Entrepreneurship and Small Business Management

SEMESTER V

BACHELOR OF BUSINESS ADMINISTRATION

BLOCK - 2

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BACHELOR OF BUSINESS ADMINISTRATION

Entrepreneurship and Small Business Management

DETAILED SYLLABUS

BLOCK-1

UNIT 9. Industrial Sickness **Pages : 175-186**

Meaning of Industrial Sickness; Warning Signals of Industrial Sickness; Causes of Industrial Sickness : External causes of Industrial Sickness, Internal causes of Industrial Sickness, Factors responsible for sickness of small business; Consequences of Industrial Sickness; Corrective Measures

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Need for tax benefits; Tax Exemption; Rehabilitation Allowance; Investment Allowance; Tax Concession to small scale industries in rural areas; Tax concession to small scale industries in backward areas; MODVAT and Small Scale industries

UNIT 11. Financing of an Enterprise **Pages : 201-231**

Meaning of Financial Planning; Needs for Financial Planning; Sources of Finance; Sources of short term finance; Capital Structure : Theories of Capital Structure, Factors determining Capital Structure; Term loan : Features of Term Loan, Significance of Term Loan, Limitations of Term Loan; Capitalisation : Over-Capitalisation, Under-Capitalisation; Venture Capital : Significance of Venture capital, Function of venture capitalists, Essential Features of Venture Capital, Advantages of Venture Capital, Venture Capital Instruments, Banks and Venture Capital; Export Finance : Importance of Export Finance, Exim Bank Finance, Forfeiting

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Concept of Commercial bank; Concept of other development financial institution : IDBI, IRBL, LIC, STCIS, SIDC's, SIDBI, EXIM BANK, NABARD, NEDFI, IFCI, UTI

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Export promotion and trends of small enterprises; Concept of major constraints; Concept of export potentials of small-scale units; Suggestions to improve exports; Meaning of e-commerce; Concept of evolution and growth; Benefits of e-commerce; Suitability of e-commerce for small units; Prospective areas for e-commerce; Challenges faced by e-commerce

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BLOCK INTRODUCTION:

This is the second block of the course “Entrepreneurship and Small Business Management”. This block consists of seven units.

The ninth unit explains the meaning of Industrial Sickness; Warning Signals of Industrial Sickness; Causes of Industrial Sickness : External causes of Industrial Sickness, Internal causes of Industrial Sickness, Factors responsible for sickness of small business; Consequences of Industrial Sickness; Corrective Measures

The tenth unit is about need for tax benefits; Tax Exemption; Rehabilitation Allowance; Investment Allowance; Tax Concession to small scale industries in rural areas; Tax concession to small scale industries in backward areas; MODVAT and Small Scale industries

The eleventh Meaning of Financial Planning; Needs for Financial Planning; Sources of Finance; Sources of short term finance; Capital Structure : Theories of Capital Structure, Factors determining Capital Structure; Term loan : Features of Term Loan, Significance of Term Loan, Limitations of Term Loan; Capitalisation : Over-Capitalisation, Under-Capitalisation; Venture Capital : Significance of Venture capital, Function of venture capitalists, Essential Features of Venture Capital, Advantages of Venture Capital, Venture Capital Instruments, Banks and Venture Capital; Export Finance : Importance of Export Finance, Exim Bank Finance, Forfeiting

The twelfth unit enlighten us with the definition of Franchising; Classification of Franchising; Features of Franchising; Types of Franchising; Advantages of Franchising : To Franchisee, To Franchisor; Disadvantages of Franchising : To franchisee, To Franchisor; Franchising Agreement; Franchising in India; Laws regarding Franchising

The thirteenth unit explains the concept of Commercial bank; Concept of other development financial institution : IDBI, IRBL, LIC, STCIS, SIDC’s, SIDBI, EXIM BANK, NABARD, NEDFI, IFCI, UTI

The fourteenth unit explains about export promotion and trends of small enterprises; Concept of major constraints; Concept of export potentials of small-scale units; Suggestions to improve exports; Meaningof e-commerce; Concept of evolution and growth; Benefits of e-commerce.

The fifteenth unit is about case studies in entreprenuship and small business management.

The structure of Block 2 is as follows :

UNIT 9 **:** Industrial Sickness

UNIT 10 **:** Tax Benefits to Small Scale Industries

UNIT 11 **:** Financing of an Enterprise

UNIT 12 **:** Franchising

UNIT 13 **:** Industrial Finance to Entrepreneurs

UNIT 14 **:** Small Enterprises in International Business and Electronic Commerce & Small Units

UNIT 15 **:** Case Studies

UNIT 9: INDUSTRIAL SICKNESS

UNIT STRUCTURE

9.1 Learning Objectives

9.2 Introduction

9.3 Meaning of Industrial Sickness

9.4 Warning Signals of Industrial Sickness

9.5 Causes of Industrial Sickness

- 9.5.1 External of Industrial Sickness
- 9.5.2 Internal of Industrial Sickness
- 9.5.3 Factors responsible for sickness of small business

9.6 Consequences of Industrial Sickness

9.7 Corrective Measures

9.8 Let Us Sum Up

9.9 Further Reading

9.10 Answers To Check Your Progress

9.11 Model Questions

9.1 LEARNING OBJECTIVES

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

- define industrial sickness
- discuss the reasons for industrial sickness
- explain the consequences of Industrial sickness
- suggest measures for solving the problem of sickness.

9.2 INTRODUCTION

In this unit we are going to discuss about the industrial sickness. Industrial sickness is an important problem related with development of a country. The problem of industrial sickness does exist equally in both the developing and the developed countries. But, it is essential to solve the problem that exists in a developing country like India for achieving

higher growth rate and maintaining adequate level of employment.

The incidence of industrial sickness has been growing in India since the announcement of economic reforms in the last decade. It is not that only some of the traditional industries like cotton textiles jute and sugar have been afflicted with sickness but even some other important industries such as engineering, chemicals, rubber, cement, electrical and paper have been affected by industrial sickness.

9.3 MEANING OF INDUSTRIAL SICKNESS

In 1985 the Sick Industrial Companies (Special Provision) Act, 1985 was enacted. This Act has offered a definition of sickness. According, to this Act, "Sick Industrial Company" indicates an industrial company (registered for not less than seven years)which is showing accumulated losses equal to or exceeding its net worth as the end of any financial year, and has suffered cash losses also during that financial year and the immediately preceding year. Here, the "Cash loss" indicates computed loss without making provision for depreciation and net worth means the total amount of capital and free reserves.

Moreover, a company will be known as "***incipiently sick***" which has already eroded 50% or even more of its peak net worth during any of the preceding five financial years.

9.4 WARNING SIGNALS OF INDUSTRIAL SICKNESS

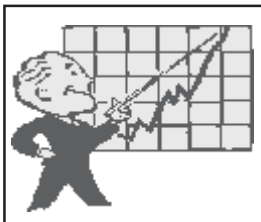
Given below are some of the warnings of Industrial sickness:

1. **Shortage of Liquid funds to meet Short-term financial obligations of Creditors as also to meet statutory obligation:** This is the first sign of sickness when an enterprise cannot pay for the purchase of raw materials, when it delays the payment to its labour. Besides this, when the Industrial unit in all violation of legal provisions, stops meeting its statutory obligations, such as contributions to Employees Provident Fund, Payment of Sales tax etc, then it is seen as beginning to suffer from industrial sickness.
2. **Growth of Excessive inventories:** Excessive accumulation of

Raw Materials, Goods-in-process and Finished goods is yet another warning signal. The failure of the firm to sell the finished goods at the pace it was doing earlier results in higher inventory accumulation.

3. **Non-payment:** Non-Payment of interest on term loans or non-payment of installments gives another signal of impending sickness.
4. **Under utilization of capacity:** Every unit of production for its survival must cross the break even point .If a firm operates below its break-even point, then it is incurring a loss and is bound to grow sick.
5. **Return on Investments:** A production unit should be capable of making an adequate provision for depreciation. For obtaining a rate of return on investment, the net profit as a proportion of the total investment in the enterprise has to be taken. Total investments should include Equity Capital and Reserve. A comparison of the rate of return with the prevailing rate of interest is indicative of the health of the enterprise.
6. **Maintenance of financial ratios:** If the ratio of current assets to current liabilities is less than 1:1 an enterprise is considered as sick. In other words, it indicates losses and declining liquidity of the firm. A declining debt-equity ratio indicates movement towards sickness.

However, the firms, more especially the sickness-prone firms, in order to put up a better image do a lot of window dressing.



CHECK YOUR PROGRESS

Q1: What do you mean Industrial Sickness?

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9.5 CAUSES OF INDUSTRIAL SICKNESS

The causes that are responsible for Industrial sickness in India are broadly classified into:

(a) External Causes and (b) Internal Causes

9.5.1 External Causes

External causes include:

a. It includes Power cuts imposed by the state Governments
b. Scarcity of raw materials and other inputs due to its erratic supply.
c. Frequent changes in the government policy in connection with industrial licensing, taxation, power tariff, imports etc. All these external factors are equally responsible for growing sickness among the industrial units of the country.

9.5.2 Internal Causes

Following are the internal causes for industrial sickness

a. Faulty location of industrial unit.
b. Defective selection of plants and machineries and adoption of obsolete technology particularly in the small scale sector.
c. Incompetent entrepreneurs having no knowledge about costing, marketing, etc.
d. Labour problems like strikes and lockouts arising from strained industrial relation over the issues like wages, bonus and industrial discipline etc.

9.5.3 Factors responsible for sickness of Small Business

Apart from the factors mentioned above fort industrial sickness in general the main factors responsible for sickness of Small Business are as given below:

1. **Lack of Managerial skills:** Most of the entrepreneurs who establish SSI units, do not have specialized knowledge of management. The overhead costs of these units are very high, borrow at high rates of interest and the inexperienced management do not care for making economies in costs, more particularly during the period of infancy.
2. **Non-Observance of management Principles:** Usually the rate of interest on the capital employed in SSI units is very high. The entrepreneurs of SSI start the enterprises with a low equity base and make no effort to build internal financial resources during the good years. Sometimes they invest Short-term borrowings in medium term inventories.
3. **Under Utilization of capacity:** This is yet another important factor responsible for sickness. Most of the industrial sectors do not utilize the full capacity due to certain reasons e.g. lack of working capital, lack of demand, and shortage of raw materials. Those industrial units which are permanently unable to utilize the optimum level of capacity slowly enter into sickness.
4. **Government policies:** The govt. policies also affect the feasibility and success of SSI units. Sometimes, the change in the government policies affects adversely the functioning of SSI units, hence these units become sick. For example, the reduction by the Govt. in the list of products reserved for being produced under SSI units in India has resulted in the sickness of numerous industrial units. These units are unable to face the completion from the large scale industries and the Multinational Corporations (MNC's).
5. **Easy approval of small- scale units by the state:** Improper screening of the projects proposals may also result in the sickness of a SSI unit. If the assessment of viability of the projects is not made with adequate care, especially with

regard to financial viability, the SSI unit likely to become sick.

6. **The dead units depended mostly on their own funds,** i.e. on their individual savings rather than on borrowed funds. Among the dead small units, own funds accounted for 89% of Gross Investments.

7. **Non-Payments** by the principals to the Ancillaries have been noted as an important cause of Industrial sickness.



CHECK YOUR PROGRESS

Q2: What are the two causes of Industrial sickness.

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Q3: Fill in the blanks:

a. Frequent changes in the government policy is an ……. ……..factor for industrial sickness.

b. ……. Utilization of capacity is an important factor responsible for industrial sickness.



LET US KNOW

Table : Statewise analysis of industrial sickness in INDIA

STATE	NUMBER OF UNITS		
	Non-SSI	Non-SSI	SSI Unit
Maharashtra	340	59	19,360

STATE	NUMBER OF UNITS		
	Non-SSI	Non-SSI	SSI Unit
West Bengal	216	27	53,451
Uttar Pradesh	170	32	23,286
Andhra Pradesh	225	39	15,460
Gujarat	174	39	6,510
Tamil Nadu	141	34	9,809
Karnataka	110	49	6,937
Kerala	64	17	8,908
Haryana	66	12	2,574
Bihar	55	9	22,702
Madhya Pradesh	91	20	12,070
Orissa	55	7	3,408
Rajasthan	67	17	14,561
Punjab	51	11	2,466
Assam	38	3	10,133
Others	85	45	23,397
Total	1,984 (100)	420 (100)	2,35,032 (100)

9.6 CONSEQUENCES OF INDUSTRIAL SICKNESS

Industrial sickness may cause serious consequences in an under-developed labour-surplus economy like India. These consequences include:-

1. Aggravating unemployment problem through the closure of Industrial Units.
2. Widespread labour unrest due to closure threatening industrial environment in the country.

3. Wastage of huge resources invested in these sick units.
4. Creating adverse impact on the other related units.
5. Causing huge financial losses to banks and other lending institutions, locking up funds in these sick units
6. Creating disincentive among the entrepreneurs and investors due to widespread closure of units.



LET US KNOW

STATE-WISE PERCENTAGE DISTRIBUTION OF SICKNESS/ INCIPIENT SICKNESS (REGISTERED SSI SECTOR)

Sl. No.	Name of the State/ UT	Sick Units	Incipient Sick Units	Sick/ Incipient Sick Units	Sick Units among Units having Outstanding Loan (Institutional Sources)
1.	Jammu & Kashmir	0.63	0.20	0.27	0.60
2.	Himachal Pradesh	0.65	0.95	0.92	0.60
3.	Punjab	4.41	6.32	6.03	3.41
4.	Chandigarh	0.00	0.02	0.02	0.00
5.	Uttaranchal	0.33	0.34	0.34	0.23
6.	Haryana	2.90	2.89	2.92	2.86
7.	Delhi	0.47	0.10	0.18	0.28
8.	Rajasthan	2.89	3.11	3.11	2.59
9.	Uttar Pradesh	2.75	2.49	2.57	2.30
10.	Bihar	1.40	1.62	1.61	1.40
11.	Sikkim	0.01	0.01	0.01	0.01
12.	Arunachal Pradesh	0.03	0.04	0.04	0.04
13.	Nagaland	0.01	0.01	0.01	0.02
14.	Manipur	0.41	0.13	0.16	0.43
15.	Mizoram	0.02	0.01	0.01	0.00
16.	Tripura	0.05	0.05	0.05	0.04
17.	Meghalaya	0.04	0.03	0.03	0.02
18.	Assam	0.34	0.40	0.38	0.32
19.	West Bengal	2.41	2.82	2.81	2.23
20.	Jharkhand	0.79	0.46	0.50	0.62
21.	Orissa	1.18	0.35	0.48	1.31

Sl. No.	Name of the State/ UT	Sick Units	Incipient Sick Units	Sick/ Incipient Sick Units	Sick Units among Units having Outstanding Loan (Institutional Sources)
22.	Chattisgarh	12.17	0.83	2.78	14.15
23.	Madhya Pradesh	2.83	2.71	2.72	2.51
24.	Gujarat	1.90	2.57	2.51	1.81
25.	Daman & Diu	0.07	0.09	0.08	0.05
26.	D & N Haveli	0.01	0.06	0.06	0.01
27.	Maharashtra	9.86	5.09	5.72	10.14
28.	Andhra Pradesh	4.49	6.55	6.32	4.04
29.	Karnataka	15.08	9.74	10.53	16.03
30.	Goa	0.32	0.21	0.21	0.21
31.	Lakshadweep	0.01	0.01	0.01	0.01
32.	Kerala	24.18	34.69	32.45	25.45
33.	Tamil Nadu	6.88	14.76	13.81	5.82
34.	Pondicherry	0.43	0.24	0.26	0.42
35.	A & N Islands	0.05	0.10	0.09	0.04
	All India	**100.00**	**100.00**	**100.00**	**100.00**

9.7 CORRECTIVE MEASURES

The problem of industrial sickness in SSI units is different from that of large scale industrial sickness. It is basically the problem of increasing the competitive strength and viability of the small units. Therefore, special efforts have to be made for preventing industrial sickness in SSI units. The measures to be adopted are as follows:

1. These units should pay special attention towards creation of financial resources and the short term capital should not be used for medium term/long term investment.
2. The managerial skills should be developed by providing training to the entrepreneurs of SSI units.

3. The Government can afford priority in allocation of scarce raw materials, extending marketing assistance and granting certain rebates and concessions to small units and more as to such units which slow better record of performance.
4. The cost of capital should be reduced and efforts should be taken to reduce overhead costs in SSI units.
5. Funds should not be utilized elsewhere, since a majority of sick units die in the second and third year of their existence, a programme of monitoring and nursing them during infancy is very essential. In this way the factors leading to low capacity utilization can be examined and quick action can be taken.
6. SSI units should maintain inventories at optimum level so that costs should be reduced and it does not affect the sales of the industry adversely.
7. Sickness of small units should be treated at par with scarcity and concessional rates of interest be charged at par with those loans, that are granted in scarcity. The maximum rate of interest should be 7% for small sick units enable them to secure soft credit.
8. The reserve bank should issue guidelines for the operation of small units and thus make professional management expertise available for the guidelines of small entrepreneurs. The management expertise should acquaint the small entrepreneurs with the need for a better equity base, retained profits and expansion programmed so as to build their internal financial strength.
9. The Government should take penal action against the principals for non-payment for the delivery of goods by small units.



CHECK YOUR PROGRESS

Q4: What are the consequences of Industrial sickness?

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9.8 LET US SUM UP

In this unit we have learnt about the industrial sickness in SSI units. The causes for industrial sickness have been discussed together with the Corrective measures to be adopted to overcome this problem.

State wise percentage distribution of sickness is also shown in a table and the situations like Growth of Excessive inventories, under utilization of capacity etc which lead to industrial sickness are also discussed in this unit.



9.9 FURTHER READING

1. B. Bhatnagar and A Budhiraja(2011), *Entrepreneurship Development & Small Business Management,* Vayu Education Of India
2. Khanka SS (2007), *Entrepreneurial Development*; S Chand & Company; Reprint Edn. 2006 edition
3. Scarborough and Cornwell (2016), *Essentials of Enterpreneurship & Small Business Management,*Pearson Education India; Eighth edition
4. Charantimath(2013), *Entrepreneurship Development and Small Business Enterprises*,Pearson Education India; Second edition
5. Pathak R.K. and Kalwar M.C.(), Business Organisation and Entrepreneurship Development



9.10 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Industrial company which is showing accumulated losses equal to or exceeding its net worth as the end of any financial year, and has suffered cash losses also during that financial year and the immediately preceding year.

Ans to Q No 2: Internal factors and External Factors

Ans to Q No 3: a. External b. Under

Ans to Q No 4: Consequences of industrial sickness:

a. Creating disincentive among the entrepreneurs
b. unemployment problem
c. Widespread labour unrest
d. Wastage of huge resources
e. Creating adverse impact on the other related units
f. Causing huge financial losses to banks



9.11 MODEL QUESTIONS

1. What is Industrial Sickness? Mention the relevant Act and discuss the definition of industrial sickness according to the Act.
2. Explain the warning signals of Industrial sickness.
3. What are the causes of Industrial sickness? Explain them.
4. Give some corrective measures to prevent Industrial sickness in SSI Units.

UNIT 10: TAX BENEFITS TO SMALL SCALE INDUSTRIES

UNIT STRUCTURE

10.1 Learning Objectives

10.2 Introduction

10.3 Need for tax benefits

10.4 Tax Exemption

10.5 Rehabilitation Allowance

10.6 Investment Allowance

10.7 Tax Concession to small scale industries in rural areas

10.8 Tax concession to small scale industries in backward areas

10.9 MODVAT and Small Scale Industries

10.10 Let Us Sum Up

10.11 Further Reading

10.12 Answers To Check Your Progress

10.13 Model Questions

10.1 LEARNING OBJECTIVES

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

- discuss the government policy towards developing and promoting small scale enterprises in the country
- give an account of the government support to small scale enterprises during five year plans
- to appreciate the need for tax benefits to small-scale industries
- to discuss the various tax benefits available to small-scale industries.

10.2 INTRODUCTION

In this unit, we are going to discuss the concept of tax benefit to small scale industries. Concessions were provided to the small scale sector in India for many years in income tax as well as excise duties. New industrial undertakings coming under the category of small scale

defined in terms of investment in plant and machinery were allowed tax holiday for a specified number of years subject to certain conditions, such as location in rural areas, and so on. Whereas the income tax holiday was granted to new undertakings only if engaged in producing goods in what was called the “priority list”, in the case of new small scale enterprises no such restriction applied. Such preferential treatment for small scale units occurred in many of the tax benefits extended in income tax to promote new industries, technological advancement, and development of backward regions. However, as mentioned above, these have largely been withdrawn or are on their way out. Concessions in excise duties, too, were provided to the small scale right from the inception of support policy for the small and tiny sector as a strategy of development and employment promotion. Excise concessions provided a potent instrument for influencing the pattern of production and technological choices in favor of employment intensive techniques because of the wide coverage of union excises and their impact on the relative prices of outputs as also inputs. In order to promote employment, products of several industries were exempted from excise if produced without the aid of power. Items so exempted included confectionery, food products, vegetable and ‘non-essential’ oils, paper and paper board, man-made fiber and yarn, footwear, steel furniture,

In this unit we are going to discuss about the government policy towards developing and promoting small scale enterprises in the country, need for tax benefits to small-scale industries and will be discussing the various tax benefits available to small-scale industries.

10.3 NEED FOR TAX BENEFITS

Small-scale industries are characterized by their small and shy resources/ capital. The first thousand days seem to be as critical in small business as in new administration. In the beginning, small industries have to incur more expenses, but the returns are either nil or nominal. Therefore, they need to be provided support and assistance to tide over the crucial initial stage to enable them to survive. Hence, the Government

has come forward with various benefits to offer to small scale industries in the country. One way to support the development of small-scale industries by the Government is to provide them tax benefits. The Government either exempts them from tax or provides them concession in tax liability. This helps small industries accumulate capital, on the one hand, and plough back profits in business, on the other.

In a developing country like India, Small Scale Industries play a significant role in economic development of the country. They are a vital segment of Indian economy in terms of their contribution towards country's industrial production, exports , employment and creation of an entrepreneurial base.These industries by and large represent a stage in economic transition from traditional to modern technology. Small industry plays a very important role in widening the base of entrepreneurship. The development of small industries offers an easy and effective means of achieving broad based ownership of industry, the diffusion of enterprise and initiative in the industrial field.

Given their importance, the Government policy framework right from the First plan has highlighted the need for the development of SSI sector keeping in view its strategic importance in the overall economic development of India. Accordingly, the policy support from the Government towards Small Scale Industries has tended to be conducive and favourable to the development of small entrepreneurial class. Government accords the highest preference to development of SSI by framing and implementing suitable policies and promotional schemes.

The most important promotional policy of the Government for the SSI's is fiscal incentives in the form of tax concessions and exemptions of direct or indirect taxes leviable on production or profits

With effect from financial year 2005-06,SSIs can claim deductions in respect of profits and gains(under section 80IB of Income tax Act) at the following rates:-

- If SSI unit is owned by a company, the deduction available is 30% for first 10 years. If SSI unit is owned by a co-operative society, the deduction available is 25% for first 10 years.

- If any other person owns SSI unit, the deduction to be claimed is 25% for first 10 years.

SSI unit can avail this tax exemption after fulfilling following conditions:

a. They should not be subsidiary of,or owned or controlled by other industrial undertakings.They should not be formed as a result of splitting up or reconstruction of any industrial undertaking/ business.SSI units can manufacture any nature or type of goods,which they are permitted to do so.They should have commenced business between 1st April 1991 and 31st March 2002.They should employ atleast 10 workers in a manufacturing process carried out with aid of power or atleast 20 workers without aid of power.This tax exemption from total income is allowed from the assessment year in which the unit begins to manufacture goods.

b. Small Scale Industries are subjected to excise duties under the Central Excise Tariff Act,1985(5 of 1986). The eligibility for excise concessions for SSIs has been based on annual turnover rather than SSI registration. SSI units having turnover less than Rs.4 crores are only eligible for concessions. Government of India has provided various concessions to SSIs by granting full exemption from payment of central excise duty on a specified output and thereafter slab-wise concessions. Thus concessions in this regard are:-

   - SSI units producing goods upto Rs.100 lakhs are exempted from payment of excise duties.
   - SSI units having turnover less than Rs.60 lakhs per annum need not have a separate storeroom for storing finished products.

c. They are not required to maintain any statutory records such as daily stock accounts, etc.Their own records are adequate. SSI

exemption is available for goods for home consumption as well as goods exported to Nepal and Bhutan.



CHECK YOUR PROGRESS

Q1: Fill in the blanks:

a. Small-scale industries are characterized by their …… resources / capital

b. SSI stands for ……

c. The most important promotional policy of the Government for the SSI's is …… incentives

d. Small Scale Industries play a significant role in …… ……development of the country .....

10.4 TAX EXEMPTION

Under Section 80J of the Income Tax Act, 1961, new industrial undertakings, including small-scale industries, are exempted from the payment of income-tax on their profits subject to a maximum of 6% per annum of their capital employed. This exemption in tax is allowed for a period of five years from the commencement of production. A small scale industry has to satisfy the following two conditions to avail in this tax exemption facility.

(i) The unit should not have been formed by the splitting or reconstitution of an existing unit.

(ii) The unit should employ 10 or more workers in a manufacturing process with power or at least 20 workers without power.

10.5 REHABILITATION ALLOWANCE

A rehabilitation allowance is granted to small scale industries under Section 33-B of the Income Tax Act, 1961 whose business is discontinued on account of following reasons :

(i) Flood, typhoon, hurricane, cyclone, earthquake, or other natural upheavals;

(ii) Riot or civil disturbance;

(iii) Accidental fire or explosion; and

(iv) Action by an enemy or action taken in combating an enemy,

and, thereafter, at any time before the expiry of three years from the end of such previous year, the business is re-established, reconstructed or revived by the assessee, he shall, in respect of the previous year in which the business is so re-established, reconstructed or revived, be allowed a deduction of a sum by way of rehabilitation allowance equivalent to sixty per cent of the amount of the deduction allowable to him under clause (iii) of sub-section (1) of section 32 in respect of the building, machin¬ery, plant or furniture so damaged or destroyed :

Provided that no deduction under this section shall be allowed in relation to the assessment year commencing on the 1st day of April, 1985, or any subsequent assessment year.

The rehabilitation allowance is allowed to the unit equivalent of 60 per cent of the amount of the deduction allowable to the unit.

10.6 INVESTMENT ALLOWANCE

The investment allowance was introduced way back in 1976 to replace the initial depreciation allowance. The investment allowance under Section 31A of the Income Tax Act, 1961, is allowed at the rate of 25 per cent of the cost of acquisition of new plant or machinery installed.

Although the investment allowance has been made available for the articles or things except certain items of low priority, yet, as per the Eleventh Schedule to the Income Tax Act, 1961, a special dispensation has been provided for the plant and machinery installed in small-scale industries. In comparison with other industries, small-scale industries are at an advantage in claiming a deduction of investment allowance.

A small-scale industry can avail of investment allowance provided it has put to use machinery or plant either in the year of installation or in the immediate following year failing which the benefit will be forfeited.



CHECK YOUR PROGRESS

Q2: State true or false:

a. The exemption in tax on small scale industries are allowed for a period of six years from the commencement of production. (T/F)

b. The investment allowance was introduced in 1976. (T/F)

c. A rehabilitation allowance is granted to small scale industries under Section 43-B of the Income Tax Act, 1961. (T/F)

d. The investment allowance is allowed at the rate of 55% of the cost of acquisition of new plant installed. (T/F)

10.7 TAX CONCESSION TO SMALL SCALE INDUSTRIES IN RURAL AREAS

The Finance (No.2) Act of 1977 inserted a new Section 80-HHA in the Income Tax Act, 1961.The tax-payers, under this Section 80-HHA, are entitled to a deduction of 20% of the profits and gains derived by running small-scale industries in rural areas. The deduction is allowed for a period of 10 years from the year of commencement of manufacturing activity after 30th September 1977. For this purpose the expression

(a) rural area means any area other than:

(i) an area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corpora¬tion, notified area committee, town area committee, town commit¬tee or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been pub¬lished before the first day of the previous year ; or

(ii) an area within such distance, not being more than fifteen kilometres from the local limits of any municipality or cantonment board referred to in sub-clause (i), as the Central Government may, having regard to the stage of development of such area

(including the extent of, and scope for, urbanisation of such area) and other relevant considerations specify in this behalf by notification in the Official Gazette.

(b) an industrial undertaking shall be deemed to be a small-scale industrial undertaking which is, on the last day of the previous year, regarded as a small-scale industrial undertaking under section 11B of the Industries (Development and Regulation) Act, 1951 (65 of 1951).

The small-scale industry can avail of this tax deduction only after fulfilling the following conditions:

(i) The small-scale unit is not formed by splitting or reconstruction of a business already in existence.

(ii) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

(iii) The accounts of the unit are audited by a chartered accountant.

(iv) It employs 10 or more workers in manufacturing process carried on with the aid of power or 20 or more workers in a manufacturing process carried on without the aid of power.

(v) The unit does not claim a simultaneous deduction under Section 80-HH of the Income Tax Act, 1961.

10.8 TAX CONCESSION TO SMALL SCALE INDUSTRIES IN BACKWARD AREAS

The Planning Commission of India, in 1970-71, declared 247 districts out of 435 districts, as backward areas with a view to provide them special incentives and concessions to establish industries in these backward areas. The newly established small-scale industries in these backward areas specified in the Eighth Schedule to the Income Tax Act, 1961 are entitled to a deduction of 20% of their profits and gains from their gross total income. This deduction is allowed for a period of 10 years beginning with the year of commencement of manufacture or production. However, if a small scale industry has already been established in a non backward area and later shifts to a backward area,

the unit will be allowed this deduction on the profits earned from the undertaking after shifting in the backward area for a period of ten years. A small scale industry established in backward area but engaged in mining activity is not entitled to such deduction benefit.

The unit has to satisfy the following conditions to be eligible to avail of this tax benefit

1. It is established on or after 31st December, 1970.
2. It employs at least 10 workers in a manufacturing process carried on with the aid of power or at least 20 workers in a manufacturing process carried on without the aid of power. With effect from financial year 2005-06, deduction in respect of profits and gains for small scale industrial undertakings is available under Section 80IB.

Small scale industrial undertaking can claim deduction at the following rates:

a. If SSI unit is owned by a company, the deduction available is 30% for first 10 years,
b. If SSI unit is owned by a co-cooperative society, the deduction to be availed is 25% for first 10 years, and
c. If any other person owns SSI unit, the deduction to be claimed is 25% for first 10 years.

The small scale units can avail this tax exemption facility only after fulfilling the following conditions:

a. No small scale or ancillary undertaking shall be subsidiary of, or owned or controlled by other industrial undertaking.
b. SSI unit can manufacture any nature/type of goods/article to avail deduction.
c. The SSI unit should commence business between 1st April 1991 and 31st March 2002.
d. They should employ at least 10 workers in a manufacturing process carried out with the aid of power or at least 20 workers in a manufacturing process carried out without the aid of power.
e. This tax exemption from total income is allowed from the

assessment year in which the unit begins to manufacture or produce goods or articles.



CHECK YOUR PROGRESS

Q3: Fill in the blanks:

a. The tax-payers, under Section 80-HHA, are entitled to a deduction of …… percent

b. A small scale industry established in backward area but engaged in mining activity is not entitled to …… benefit.

c. If SSI unit is owned by a company, the deduction available is ……..% for first 10 years.

10.9 MODVAT AND SMALL-SCALE INDUSTRIES

The vexatious question of the taxation of inputs and its cascading effect ultimately on the value of the final product was a matter of much debate and concern for quite some time. The solution to the question was ultimately envisaged in extending the present ongoing system of proforma credit to all excisable commodities barring a few ones. This new scheme is known as Modified Value Added Tax (MODVAT). MODVAT refers to an excise duty scheme introduced in 1986 for allowing relief to final manufacturers on the excise duty borne by their suppliers for goods manufactured by them. It has now been replaced by the CENVAT scheme. It applies to certain specific items and is meant to limit the cascading effect of duty incidence on a number of goods where the MODVAT credit can be claimed on the purchase of raw materials on which excise has been paid. This MODVAT credit can be used to set off the excise duty payable on subsequent manufacture of goods.

Where the SSI unit does not avail CENVA: Notification No.8/2000-CE, dated 1st March, 2000 as amended. For first clearances effective from 1st April of a financial year up to an aggregate value of Rs. 1 Crore,

duty is exempted in respect of those SSI units which do not intend to avail CENVAT up to a value of clearances of rupees one crore.

Where the SSI unit avails CENVAT: Notification No.9/2000-CE, dated 1st March, 2000 as amended. The graded scheme of exemption in respect of those SSI units which intend to avail CENVAT is as under:-

Sr. No. Value of Clearances Rate of Duty

1 First clearances effective from 1st April of a financial year

Up to an aggregate value of Rs.1 crore 60% of the normal rate of duty

2 Subsequent Clearances at the normal rate of duty

The following clearances are excluded from computation of value of clearances

- Clearances of the specified goods which are used as inputs for further manufacture of specified goods within the factory irrespective of the value of clearances.
- Clearances of excisable goods affixed with the brand name or trade name of another person who is not eligible for availing the exemption under the aforesaid notification.

An SSI who is to take the benefit of Cenvat scheme must give a letter of C.Ex. and maintain the appropriate registers. Before availing cenvat, the SSI must physically receive the goods under a duty paying document or a proper invoice issued by a registered dealer. The SSI must maintain an registers giving details of receipt and disposed of inputs & capital goods and payment of duty by credit. Registers. Once he has availed cenvat on a duty paying document the documents must be defaced so that it can not be used again. This duty paying document already defaced and the record along with his own delivery documents must be shown to the Central Excise officers on demand. There is a provision for removing raw materials, inputs or capital goods on which cenvat credit has been taken out of the factory for further processing, repairs or job work. Details of the cenvat scheme may be obtained from the local Central Excise officer. Please note that when duty is being paid vide cenvat credit, the credit accruing on goods received after the last

day of the month in which duty is due to be paid, can not be utilized (CBEC's circular 542/38/2000-Cx. Dated 25.8.2000)

The MODVAT (now CENVAT) scheme intends to greatly and gradually expand its horizons so as to set-off excise and other countervailing duties paid on various inputs of final product. This aims at coming closer to generalized get-off excise taxation on inputs. For this, the basic approach to be followed is to move towards the extension of ongoing system of proforma credit to all excisable commodities. A few sector/products like textile products, petroleum and tobacco have been left for this purpose. This programme is to be implemented in a phased manner over a period of years mainly considering its implication on revenue account.

It is important to mention that neither the MODVAT programme intends to raise maximum revenue nor to give substantial relief on excise. Any loss of duty on inputs will be recouped through higher excise taxation on final products. Thus, the shifting of burden of excise taxation away from inputs on to their final products is the core of the MODVAT scheme. Such shifting of tax burden also implies that the richer will have to bear more tax burden than the poor. It is good to reduce differences in income levels between the rich and the poor.



CHECK YOUR PROGRESS

Q4: State true / false

a. MODVAT means Motivated Value Added Tax. ..... (True / False)

b. The investment allowance was introduced way back in 1976. (True / False)

c. Rehabilitation allowance is not allowed due to accidental fire or explosion. (True / False)

d. To avail of the tax exemption small scale industry should employ 10 or more workers with power. (True / False)



10.10 LET US SUM UP

The need for tax benefit to small-scale industries is justified on two grounds-

(i) to promote investment in small-scale industries, and

(ii) to provide them tax relief in the initial period. Accordingly, various tax benefits are provided to small scale industries.

- The principal tax benefits provided to small scale industries are tax holiday, rehabilitation allowance, investment allowance etc.
- MODVAT envisages special tax benefits on inputs and final products of small-scale industries.
- Tax benefits to small scale industries intended to promote the development of small sector in the country.



10.11 FURTHER READING

1. B. Bhatnagar and A Budhiraja(2011), *Entrepreneurship Development & Small Business Management,* Vayu Education Of India
2. Khanka SS (2007), *Entrepreneurial Development*; S Chand & Company; Reprint Edn. 2006 edition
3. Scarborough and Cornwell (2016), *Essentials of Enterpreneurship & Small Business Management,*Pearson Education India; Eighth edition
4. Charantimath(2013), *Entrepreneurship Development and Small Business Enterprises*,Pearson Education India; Second edition
5. Pathak R.K. and Kalwar M.C.(), Business Organisation and Entrepreneurship Development



10.12 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No.1: a. Small and Short b. Small Scale industries c. fiscal d. economic

Ans to Q No.2: a. False b. True c. False d . False

Ans to Q No.3: a. 20 b. deduction c. 30

Ans to Q No.4: a. False b. True c. False d. True



10.13 MODEL QUESTIONS

1. Discuss the need for tax benefits to small-scale industries.
2. Discuss the special tax benefits available to small-scale industries working in rural and backward areas.
3. Write short notes on the following :-
   (a) Tax Holiday
   (b) Rehabilitation Allowance
   (c) MODVAT and Small scale industries.
   (d) Investment Allowance

UNIT 11: FINANCING OF AN ENTERPRISE

UNIT STRUCTURE

11.1 Learning Objectives

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11.3 Needs for Financial Planning

11.4 Sources of Finance

11.5 Sources of short term finance

11.6 Capital Structure

- 11.6.1 Theories of Capital Structure
- 11.6.2 Factors determining Capital Structure

11.7 Term Loans

- 11.7.1 Features of Term Loan
- 11.7.2 Significance of Term Loan
- 11.7.3 Limitations of Term Loan

11.8 Capitalisation

- 11.8.1 Over-Capitalisation
- 11.8.2 Under-Capitalisation

11.9 Venture Capital

- 11.9.1 Significance of Venture capital
- 11.9.2 Function of venture capitalists
- 11.9.3 Essential Features of Venture Capital
- 11.9.4 Advantages of Venture Capital
- 11.9.5 Venture Capital Instruments
- 11.9.6 Banks and Venture Capital

11.10 Export Finance

- 11.10.1 Importance of Export Finance
- 11.10.2 Exim Bank Finance
- 11.10.3 Forfeiting

11.11 Let Us Sum Up

11.12 Further Reading

11.13 Answers To Check Your Progress

11.14 Model Questions

11.1 LEARNING OBJECTIVES

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

- describe the concept of financial planning
- explain the various sources of Finance
- describe the importance of Capital Structure
- discuss the features and significance of Term Loans
- explain the effect of Capitalisation
- have a detailed idea about venture Capital and Export Finance.

11.2 INTRODUCTION

In this unit we are going to discuss the concept financing of an enterprise. Finance is an important function of business. The application of planning to this function is financial planning. This function is mainly concerned with the economical procurement and profitable use of funds. Financial policy and procedures are the broad guides in the procurement, administration, and disbursement of funds. Financial planning is an important function of a financial manager. Whether the business is big or small, this function has to be performed. Similarly both an existing and a new business have to plan this function with great care. A well-prepared financial plan will not only ensure the procurement of sufficient funds but their proper utilization also.

A Financial plan is a statement estimating the amount of capital and determining its composition. The quantum of funds needed will depend upon the asset requirements of the business. The time at which the funds will be needed should be carefully decided so that finances are raised at the time when these are needed.

The concept of financial plan as conceived by Walker and Baugh is still wider. According to them, financial planning pertains only to the function of finance and includes the determination of the firm's financial objectives, financial policies and financial procedures.

11.3 NEED FOR FINANCIAL PLANNING

1. To ensure supply of sufficient funds to the firm so that it may

employ its resources up to the optimal point.

2. To minimize the cost of funds by procuring funds under the most favorable circumstances commensurate with the risk, owners are willing to assume.
3. To match the cost with risks as to protect the owners against the loss of control or business.
4. To provide flexibility in the plan so that the financial structure of the company may be adjusted in the light of changed circumstances.
5. The number of securities should be limited so that it is easily understood.
6. The financial plan ensures sufficient funds for genuine needs. The plans should suffer neither due to shortage of funds or the wasteful use of them.

11.4 SOURCES OF FINANCE

1. **Long Term Finance:** Funds needed for acquiring fixed assets like building, land, plant and machinery etc. are known as long term finance. The long term sources of finance such as shares, debentures, and retained earnings are raised mainly for a period of less than 10 years.

2. **Medium Term Finance:** Funds required for meeting long term needs of the working capital are known as medium term finance. The medium term sources of finance such as debentures, financial institutions, public deposits and commercial banks are raised for a period between 1 year and 10 years.

3. **Short Term Finance:** Funds required for meeting the short term needs of the working capital are known as short term finance. The sources such as public deposits, trade credits and commercial banks are raised for a period of 1 year and less than one year.

Some of these sources mentioned above are thereby described below:

a. **Shares:** The capital of a company is usually divided into certain indivisible units of a definite sum. These units are called Shares".

Shares represent the interest of shareholders in a company measured in terms of money. Shares are also called ownership securities and can be transferred from one person to another person. They are the owners of the company and are called Shareholders. They are the owners of the company. India a public company may issue two kinds of shares. They are 1.Preference shares and 2. Equity shares.

b. Preference Shares: Preference share are those shares which carry preferential rights in respect of dividend and repayment of capital in the event of the winding up of the company. Companies may resort to this technique as long-term capital on account of the above advantages .Since preference shareholders have no voting rights, they do not have to take any risk and hence ownership is not affected.

c. Equity Shares: Shares which do not enjoy any of the preference shares are known as equity shares or ordinary shares. Equity shares are the most important sources of finance for fixed capital and they represent the ownership capital of a company. Equity shareholders are the real owners of the company and bear the risk of business. Hence, they are known as the risk bearers and the capital they contribute is called venture capital.

d. Retained profits or ploughing - back of profits: When a company retains a part of undistributed profits in the form of free resources and the same is utilized for further expansion, it is known as “Ploughing-back of profits” or “retained earnings.” The amount so retained should have otherwise gone to shareholders as dividend. It is therefore treated as “ownership fund”.

The need for retained earnings arises on account of the following reasons:

i. To expand both fixed capital as well as working capital for further expansion and development.

ii. To improve the efficiency of the plant and equipment.

e. Debentures: Under section 2(12) of the Companies Act, 1956,

Debentures include debentures stocks, bonds and other securities of a company whether or not constituting a charge on the assets of the company. In other words, debenture is a certificate issued by a company under its seal acknowledging a debt due by it to its holders. It is a creditor ship security. Debenture holders are, therefore known as the creditors of the company. They are entitled to periodical payment of interest at a fixed rate.



CHECK YOUR PROGRESS

Q1: What are the sources of Finance?

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Q2: What is financial plan?

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11.5 SOURCES OF SHORT TERM FINANCE

i. **Public deposits:** The deposits made by the public with the joint stock companies are known as “public deposits”. These deposits are taken from the members or the directors of the company or from the general public at a specified rate of interest for a specified period. Thus the depositors are ordinary creditors. Industrial and commercial enterprises resort to this mode of financing for meeting their medium-term financial requirements.

ii. **Commercial Banks:** Commercial banks play a very significant role in financing the short term requirements of companies. They provide finance by way of loans, overdrafts, cash credits, and discounting bills. They provide a wide variety of loans tailored to meet the specific requirements of a concern.

iii. **Trade credit:** Trade credit refers to the credit extended by the suppliers of goods in the normal course of business. Trade credit includes transactions on the current account which is evidenced solely by entries in the accounts of the parties, and transactions for which bills payable at specified future dates are given by the purchaser to the vendor. Trade credit has some advantages such as:

i. It is an easy and convenient method of finance.
ii. It is flexible as the credit increases with the growth of the firm.
iii. It is informal and spontaneous source of finance.

iv. **Factoring:** Factoring means an arrangement between a factor and his client, which includes at least two of the following services to be provided by the Factor:

i. Finance.
ii. Maintenance of accounts
iii. Collection of debts
iv. Protection against credit risks.

v. **Advances:** Some business houses get advances from their customers and agents against orders and this source is short term finance for them. It is a cheap source of finance.

vi. **Accrued expenses:** Accrued expenses are the expenses which have been incurred but not yet due and hence not yet paid also. When the activity level expands, accruals also increase and hence they provide a spontaneous source of finance. Further as no interest is payable on accrued expenses, they represent a free source of finance.

vii. **Deferred Incomes:** These are the incomes received in advance before supplying goods or services. They represent funds which increase the liquidity of a firm and constitute an important source of short- term finance.

viii. **Commercial paper:** It is usually bought by investors including banks, insurance companies, unit trusts and firms to invest surplus funds for a short period. Commercial paper is a cheaper source

of raising short term finance as compared to the bank credit and proves to be effective.



CHECK YOUR PROGRESS

Q3: Fill in the blanks:

a.Deposits made by the public with the joint stock companies are known as ……

b. Factoring means an arrangement between a factor and his ……

c. …… are received in advance before supplying goods or services

d. Commercial paper is a …… source of raising short term finance.

11.6 CAPITAL STRUCTURE

According to Gerestenbeg, " Capital structure of a company refers to the composition or make-up of its capitalization and it includes all long term capital resources viz. Loans, shares, and bonds."Capital structure of a company refers to the composition or make-up of its capitalization and it includes all long term capital resources viz., loans, reserves, shares and bonds. In other words it is composed of long-term debt; preferences share capital and shareholder's funds.

A. FORMS OF CAPITAL STRUCTURE: The capital structure of a new company may consist of any of the following forms:

i. Equity Shares only
ii. Equity and Preferences Share
iii. Equity Shares and Debentures
iv. Equity Shares, Preferences Shares and Debentures.

B. IMPORTANCE OF CAPITAL STRUCTURE:

i. There should be a proper mix of debt and equity capital in financing the firm's assets.

ii. An optimum capital structure is important to maximize the value of the firm.

iii. Only a sound capital structure gives the benefit of financial leverage or trading on equity i.e., earn more by the use of long-term fixed interest bearing debt than their cost so as to increase the return on equity shareholders.

C. OPTIMAL CAPITAL STRUCTURE: The optimum capital structure is that structure or combination of debt and equity that leads to the maximum value of the firm. It maximizes of the value of the company and hence the wealth of its owners and mini9mises the company's cost of capital.

11.6.1 Theories of capital structure

The important theories of capital structure are:

i. Net Income Approach

ii. Net Operating Income Approach

iii. The Traditional Approach

iv. Modigliani and Miller(MM)Approach

i. Net Income Approach - According to this approach a firm can minimize the weighted average cost of capital and increase the value of the firm as well as market price of equity shares by using debt financing to the maximum possible extent.

ii. Net Operating Income Approach - This approach states that change in the capital structure of a company does not affect the market value of the firm and the overall cost of capital remains constant irrespective of the method of financing.

iii. The Traditional Approach – Under this approach the value of the firm can be increased initially or the cost of capital can be decreased by using more that as the debt is cheaper source of funds than equity. Thus, optimum capital structure can be reached by a proper debt equity mix. Beyond a

particular point, the cost of equity increases because increase debt increases the financial risk of the equity share holders.

iv. **Modigliani and Miller (MM) Approach –** It is identical with the net operating income approach if taxes are ignored. However, when corporate taxes are assumed to exists, their hypothesis is similar to the net income approach.

11.6.2 Factors determining capital structure

The capital structure of a concern depends upon number factors such as:

i. **Trading on Equity-**Earning more by the use of long-term fixed interest bearing debt than their cost so as to increase the return on equity shareholders is called trading on equity.

ii. **Cost of capital-** It refers to the minimum return expected by its suppliers. While formulating a capital structure an effort must be made to minimize the overall cost of capital.

iii. **Control-** Whenever additional funds are required by a firm, the management of the firm wants to raise the funds without any loss of control over the firm and in this case they might raise the additional funds by way of fixed interest bearing debt.

iv. **Nature and size of a firm-** It is also an important factor which influences capital structure.

v. **Flexibility-** Capital structure of a firm should be flexible, i.e., it should be such as to be capable of being adjusted according to the needs of the changing conditions.

vi. **Capital market conditions-**They do not remain the same forever and as such the choice of securities is also influenced by the market conditions.

vii. **Assets Structure-** The liquidity and the composition of assets should also be kept in mind while selecting the capital structure.

viii. **Purpose of financing-** If funds are required for a productive

purpose debt financing is suitable and if funds are required for unproductive purpose then equity capital should be preferred.

ix. **Cost of floatation-**The costs of floatation of various kinds of securities should also be considered while raising funds. The costs of floating as a percentage of total funds decrease with the increase in size of the issue.

x. **Corporate tax rate-** High rate of corporate taxes on profits compel the companies to prefer debt financing because interest is allowed to be deducted while computing taxable profits.

xi. **Legal Requirements-** The legal restrictions are very significant as these lay down a framework within which capital structure decision has to be made.



CHECK YOUR PROGRESS

Q4: What the forms of Capital structure?

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Q5: What are the four theories of capital structure?

a) .....

b) .....

c) .....

d) .....

11.7 TERM LOANS

The term loan is popularly used to denote the granting of an advance in lump sum, usually on the basis of some acceptable securities. Under the loan system credit is given for a definite purpose and for a

predetermined period. Term loans constitute the major form of intermediate term financing. Unlike short term which is self-liquidating over a period of less than a year, term loans are given for a period of more than one year but less than ten years. Such loans are generally employed to finance more a permanent portion of working capital requirements. As a result, most of those loans are paid in regular and periodic installments although there are exceptions to the rule.

Term loans may take the form of an ordinary loan or a revolving credit. In ordinary term loan the lender lends funds as per the agreement outright for a period of more than a year and up to 10 years. Term loans are contractual in nature. Such loans are granted as per the comprehensive terms of loan agreement.

11.7.1 Features of Term loan

1. Term loans bear a maturity period of more than one year but less than ten years. In India Commercial banks provide term loans for a period of five to seven years.
2. Term loans are sought for financing the core portion of working capital and research and development activities. Term loans are used to meet all expenses including those for repairs, replacement of equipments etc. They are also used for the purchase of capital assets for the establishment of new industrial units, for expansion, modernization or diversification. It also becomes easier for the banker to monitor and control the use of bank credit as compared to advances made by way of cash credit or overdraft.
3. Funds are provided at one go for a single transaction. If additional funds are required the customer has to apply a fresh and renegotiate terms for a new loan or even for the renewal of the existing loan.
4. Terms loans are repayable at stated intervals, monthly, quarterly or semi-annually. Repayments take place in equal installments.

5. Repayment of the loan generally begins sometime after the grant of the loan so as to enable the borrower to make profitable use of funds.
6. Flexibility is the in-built feature of the term loan. Maturities, repayments etc., may be tailored to satisfy the needs of individual borrowers. Even the loans may be taken in installments suiting the fund requirement of the enterprise.
7. Operating cost of a term loan for a banker is lower than in case of other methods of advances.
8. Term loans are more frequently secured than short term loans due to greater risks involved in term lending. Term loans are usually secured against mortgage on the land and building owned by the firm. The amount of these loans does not exceed the appraised (evaluated) value of the property.

11.7.2 Significance of Term Loan

Term loan is emerging as an important source of business financing in recent years because of added advantages of easy availability of the loan and its cheapness and flexibility.

Since the terms of the loan are the outcome of direct negotiation between the lender and the borrower, the same can be tailored to satisfy the needs of the borrower.

Firms which need funds for a longer period of time but are handicapped to make use of debenture funds owing to their over-indebtedness can gainfully take recourse to term loans. Where some terms of the term loan seem to be onerous and annoying and may shorten the operational ability of the firm in future the borrower will have the advantage of persuading the lender to make reasonable and appropriate modifications in the loan agreement. This is another attraction of the term loans.

11.7.3 Limitation of Term Loan

There are certain limitations of term loans some of which are

given below:

1. The borrowing firms find it difficult to fulfill the conditions and consequently face the threat of withdrawal of loans granted earlier. It may not always be possible to modify the onerous terms of the loan agreement.
2. Another limitation of term loans including fixed obligations is those of any borrowing including bonded debt. Borrowing more of term loans may restrict the borrower's ability to take loans in future. Increasing indebtedness poses before the firm the problem of raising capital from the market and sometimes term loans may be less attractive when the maturities and repayment schedules desired by the banks are more restrictive as compared with the ones associated with bond issue.

Finally, it may be concluded that a firm desiring funds for a period of 8 to 10 years will find term loan as the most useful and significant source of finance.



CHECK YOUR PROGRESS

Q6: What do you mean by Term Loans?

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Q7: Sate true or false:

a. Term loans are contractual in nature. (True /False)
b. Term loans bear a maturity period of less than one year. (True /False)
c. Rigidity is the in-built feature of the term loan. (True / False)
d. Terms loans are repayable at stated intervals, monthly, quarterly or semi-annually. (True /False)

11.8 CAPITALISATION

Capitalization refers to the process of determining the plans of financing. According to Grettenberger, 'Capitalization comprises of a company's ownership capital which includes capital stock and surplus in whatever form it may appear and borrowed capital which consists of bonds or similar evidences of long term debt."

The need for capitalization arises not only at the time of incorporation or promotion of a company but also as a going concern after promotion and during the life time of a corporation. Generally the problem arises at the time of expansion, amalgamation, re-organization of capital etc.

11.8.1 Over-Capitalisation

It refers to the state of affairs where the earnings of a company do not justify the amount of capital invested in its business.

A. Causes of over- capitalisation: There are many factors which account for the situation of over capitalization of a company. Following are some of the important causes of over capitalization.

a. *Over issue of capital:* sometimes, while floating a new company, the promoters over estimates the financial requirements, and as a result, they raise more capital than what is actually needed, resulting in over capitalization.

b. *Promotion, formation or development during inflation:* If a company is to be floated during an inflationary period, or any development activity is carried out in such a period, it will be victim of over-capitalization because it has to spend huge amounts.

c. *Buying assets of lower value at higher prices:* if promoters buy assets of lower values at higher prices, they are led to a situation of over capitalization because assets of lower value will be shown at higher value in the balance sheet.

d. *Taxation policy:* High rates of taxation may leave little in the hands of the management to provide for depreciation, replacements and dividends. This will adversely affect earnings capacity and thus leads to over capitalization.

e. *Under estimation of the capitalization rate:* if the rate of capitalization is under estimated, it will lead to a situation of over capitalization.

B. Effects or evils of over capitalisation: Over capitalization affects not only the company and its owners (shareholders) but also the society as a whole. The evil effects of over capitalization are discussed below:

a. *Effects on the company:* The effects of over capitalization on the company itself are disastrous in many ways:

i. Loss of good will: In an over capitalized company, there is a reduced earning capacity resulting in the fall of market price of its shares and thereby shaking up the investor's confidence. a company whose shares sell below the face value may find it difficult to improve its good will in the market.

ii. Poor creditworthiness: reduced earnings of an over capitalized concern affect its creditworthiness and as a result, it becomes difficult for it to get loans or credit at cheaper rates of interest.

iii. Decline in efficiency of the company: To cover for one loss, other losses are incurred by the company and in the process overall efficiency of the company declines. Such a company usually does not make adequate provisions for depreciation, repairs and renewals, etc, leading to further decline in its efficiency.

iv. Loss of market: over capitalized companies fail to

produce goods at competitive costs and hence often lose their market to competitors.

v. Liquidation of company: an over capitalized company goes into liquidation unless drastic steps are taken to re-organize the whole capital structure, and reorganization would itself lead to a lot of problems.

b. *Effects on shareholders:* As shareholders are the real owners of the company, they suffer most on account of over capitalization. Some of the major effects of over capitalization on shareholders are:

i. Reduced dividends: An over capitalized company will not be able to pay a fair rate of dividend to its shareholders because it is earning a low rate return on its capital. More so the payments of dividends become uncertain and irregular.

ii. Fall in the value of shares: low rates of earnings and reduced dividends because fall in the market value of shares of the over capitalized company. Thus, shareholders have to suffer a loss in capital due to depreciation of their investments.

iii. Loss on speculations: The prices of the shares of an over capitalized company remain unstable because of speculative dealings in such shares. This malpractice further adds to losses of the shareholders.

iv. Loss on re-organization: An over capitalized company has to often resort to re-organization and reduction of its capital in order to write off the accumulated losses. This results in the reduction of face value of shares and loss to its owner.

c. *Effects on society:* It has been said earlier that over capitalization affects not only the company and its owners but also the society as a whole.

i. Loss to consumer: in order to prevent declining trend

of income, an over capitalized concern resorts to increased prices and reduction in quality of its products. Hence, consumers have to suffer by paying more for the poorer quality.

ii. Loss to workers: an over capitalized company tends to reduce wages and welfare facilities of the workers to reduce losses of the earnings. no consideration is given to the demands of the workers and some of them even lose their jobs because of lay offs retrenchment and closure of such units.

iii. Under or mis-utilisation of resources: an over capitalized concern either misutilises or under utilizes its resources. Hence, the scare resources of society are not properly utilized.

iv. Gambling in shares: another social evil of over capitalization is promotion of gambling habits by providing scope for gambling in shares of such a company.

C. Remedies for over-capitalisation: The evils effects of over-capitalization are so grave that the management must take remedial measures to rectify the situation as soon as the first symptoms of over-capitalization are observed by the firm. The following remedial measures can be suggested:

i. *To have efficient management:* Management should try to become more efficient and try to curb excess expenditure.

ii. *Redemption of preference shares:* Preference shares carrying high rate of dividend should be redeemed out of retained earnings in order to raise the share of equity shareholders.

iii. *Reduction of funded debts:* Debentures, public deposits and loans taken at higher rates of interest should be prepaid out of accumulated profits.

iv. *Re-organization of equity share capital:* The face value or

the number of equity shares may be reduced in order to rectify over- capitalization.

11.8.2 Under-Capitalisation

According to Grettenberger," A company may be under-capitalized when the rate of profits it is making on the total capital is exceptionally high in relation to the return enjoyed by similarly situated valued companies in the same industry, or when it has too little capital with which to conduct its business."

A. Causes of under-capitalisation:

i. Under-Estimation of Capital Requirements: If the future capital requirements are under estimated by the promoters, the inadequacy of capital is experienced at a later stage.

ii. Under- Estimated of Future Earnings: While preparing the financial plan, if the future earnings of the company are under estimated and the actual earnings turn out to be higher than the estimated figure, the company may find itself in a condition of under-capitalization.

iii. Promotion during depression: Companies promoted during a period of depression often experience under capitalization when inflation sets in because of a sudden rise in their earnings.

iv. Conservative Dividend Policy: If the management of a particular company adopts an orthodox dividend policy. I.e. where it follows a continuous policy regarding the distribution of dividend and keeps a major part of earnings for Re-investment purpose, it results into higher earnings.

v. Desire of control and Trading on Equity: In many companies, the promoter desires to retain control the company and raise lesser amount of share capital. Later, when the funds are required they resort to trading on equity. This raisings of funds at a lower rate of interest than the earnings of the company eventually leads to under- capitalization.

B. Effects of under-capitalisation: Under-capitalization also has many evil effects on the company and its owners as well as the society as a whole:

i. As a consequence of under- capitalization earnings per share increases and so does the dividend per share, which in turn increases the marketability of shares.

ii. The companies earn huge profits and a result the burden of tax is great. The Government introduces higher rate of taxation which is a financial burden on the companies.

iii. Higher profits earned by the companies gives a psychological feeling to the customers that they are being over-charged and hence they develop a grouse towards that company.

iv. A situation of over- trading by the company may arise as a result of under-capitalization.

v. As a result of over-trading creditors will not be paid timely and the company will effect its creditworthiness adversely.

C. Remedies for under-capitalisation:

i. Fresh Issue of shares: If under-capitalization is due to inadequacy of capital then it can be corrected by the issue of fresh shares the company may also redeem its long term debt by the issue of fresh share capital.

ii. Issue of Bonus shares: the company may issue bonus share by capitalizing its accumulated earnings.

iii. Increasing the par value of shares: The Company may revalue its assets and increase their values. In that case par value may also be increased.

iv. Splitting stock: Another effective method of correcting under capitalization is to split up the existing stock into larger number of shares reducing the value of each share.



CHECK YOUR PROGRESS

Q8: What is Financial Planning?

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Q9: Mention the types of Capitalisation

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Q10: State two sources of Short term finance.

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11.9 VENTURE CAPITAL

Venture capital is a new age financing concept which has revolutionized the business and industrial sector. Venture capital is a start up financing of high risk and high growth projects in the form of equity capital or loans. Venture capital refers to the risk capital supplied to growing private companies and it takes the form of share capital in the business firms. Venture capitalists take huge risk in anticipation of high returns and hence it is also known as 'risk capital'.

In broader sense, venture capital refers to the commitment of capital and skills for the formation and setting up of firms particularly to those specializing new ideas or new technology. Thus, it is not merely an injection of funds into a new firm but also a simultaneous input of skills needed to set the firm up, design its marketing strategy, organize and manage it.

Venture capital is associated with successive stages of the firm's

development with distinctive types of financing, appropriate to each state of development. Thus, there are four stages of a firm's development, viz., development of an idea, start up, fledging, and establishment.

11.9.1 Significance of Venture capital

- Venture capital financing is one of the most recent entrants into the capital market. There is significant scope for them in the context of the emergence of technocrat entrepreneurs who have technical competence and expertise but lack venture capital.
- The significance of venture capital lies in the fact that it does away with the demerits of traditional financing which only finances proven or established process or technology.
- Venture capital is a type of financial service which helps an entrepreneur to translate his ideas into realities.
- It is an important source of funds for technology based business concerns.
- The importance of venture capital for companies is to give commercial support to new ideas and for the introduction and adaptation of new technologies. There is a high degree of risk involved in venture capital financing.
- It is a long term investment. The benefit of profit from the venture capital investment starts accruing after a period of about 5 years.
- It not only plays an important role in financing hi-technology projects, but also helps to turn research and development projects into commercial production. Venture capital besides financing the technology is also involved in fostering the growth and development of enterprises. In the western countries much of this capital is put behind establishing technology and expanding business or is used to help the evolution of new management teams.

11.9.2 Function of venture capitalists

1. Venture capitalists provide this form of capital to projects which are established to introduce new product, invention, idea etc.
2. Venture capitalist provides finance as well as skills to new enterprises and new ventures of existing ones based on high technology innovations and hence can be considered as an important device of promoting entrepreneurship development.
3. Venture capitalists duty extends even as far as to see that the firm has proper and adequate banking and receivable financing.
4. Venture capitalist assists the entrepreneurs in locating interviewing and employing outstanding corporate achievers to professionalize the firm.
5. Venture capitalist fills the gap in the owner's funds in relation to the quantum of equity required to support the successful launching of a new business or the optimum scale of operations of an existing business.

11.9.3 Essential Features of Venture Capital

The following are the essential features of venture capital:

1. **Equity participation:** The venture capitalist directly purchases shares or convertible securities of the new venture. This is done to make capital gains by disposing off the shares once the venture becomes highly profitable.
2. **Long- term investment:** Venture capital is a long term financial assistance. It necessitates the venture capital provider to wait for a long period to earn high return.
3. **Participation in management:** Venture capital makes way for the venture capitalists to participate in the management of the concerned venture or enterprise. This protects their

interest and the relation with the entrepreneur becomes cordial.

4. **Additional benefits:** More than finance the venture capitalist also helps the new firm in the field of marketing technology, Planning etc.

11.9.4 Advantages of Venture Capital

Venture capital has played an important role in exploring vast and untapped potentialities. It has promoted innovations in the field of business.

The main advantages of venture capital are:

1. In helps in the growth of industries.
2. It helps in technological innovations.
3. It helps in the growth of entrepreneurs.
4. It generates employment opportunities by promoting new ventures.
5. It also benefits the investors by allowing them to invest in a venture when it starts earning profit.

11.9.5 Venture Capital Instruments

The Various venture capital instruments available in India are enumerated below:

1. **Equity:** Venture Capital firms provide Equity with an Intention to ultimately sell them off to make capital gains. However, their contribution does not exceed 49% of the total equity capital. The effective control remains with the entrepreneur.
2. **Conditional loans:** It is a kind of a loan on which no interest is paid. The Venture capitalist is repaid in the form of royalty after the venture is able to generate sales. In India the rate of royalty ranges between 2% and 15% depending on several factors.
3. **Income note:** It is a kind of finance provides by the venture

capital firms on which the entrepreneur has to pay both interest and royalty on sales at substantially low rates. The rate of interest is not fixed and varies depending on the phases of development of the enterprise.

4. **Other instruments:** Participating debentures, partially convertible debenture and cumulative convertible preference shares are the other instruments of venture capital.

11.9.6 Banks and Venture Capital

The venture capital is comparatively new phenomenon in India. Initially public financial institutions started venture capital fund in India. Prominent among them are:

1. Risk Capital and Technology Finance Corporations Ltd promoted by the IFCI in 1975.
2. IDBI'S Venture Capital Fund set up in 1986.
3. ICICI Venture Fund Management Company promoted by ICICI along with the UTI in 1988.
4. SIDBI"S Venture capital fund set up in 1992-1993.
5. Apart from these Venture Capital Funds certain commercial banks have also set up Venture Capital funds through their subsidiaries.

   Some of these are:

   i. SBI Venture Capital Fund (By SBI Capital Market)

   ii. Can Bank Venture Capital Fund.(By Can Bank Financial Services Ltd)

   iii. India Investment Fund (By ANZ Grind lays Bank now known as Standard Chartered bank)



CHECK YOUR PROGRESS

Q11: State True/False:

a.Venture Capital is a short term investment. .....(True/ False)

b. Risk Capital and Technology Finance Corporations Ltd promoted by the IFCI in 1975. (True/ False)

c. The venture capitalist directly purchases shares or convertible securities of the new venture.(True/ False)

d. Venture capital is a type of non-financial service. (True/ False)

11.10 EXPORT FINANCE

The Commercial banks, the major source of export finance in India, provide finance before shipment of goods as well after shipment of goods.

A. Pre-shipment Finance: Pre-shipment finance refers to finance extended to purchase, processing or packing of goods meant for exports. It is in the form of packing credit facility. Packing credit is bank advance provided to an exporter for the purpose of buying, manufacturing, packing, and shipping goods to foreign buyers. Packing credit is a short term credit which is normally required to be liquidated within 180 days by negotiation of export bills or receipts of proceeds for exports.

There are three broad types of packing credit:-

a. *Clean packing credit* – It represents an advance made to the exporter on the basis of a firm export order or a letter of credit, without any control over raw materials.

b. *Packing credit against Hypothecation of goods*- the goods meant for exports are hypothecated to the bank a security. When the bank advance is to be utilized the exporter are required to furnish stocks statements and continue to do so whenever is stock movement.

c. *Packing Credit against Pledge of Goods*- The goods meant for export are pledged to the bank with an arrangement with an approved clearing agent who ships the same on the advice of the exporter.

B. Post-shipment finance: Financial assistance extended after the shipment of exports falls within the scope of post shipment finance. The finance provided after the shipment may be in the following forms.

a. *Purchase or Discounting of Documentary Export Bills*- A Commercial Bank may purchase export bills drawn payable at sight covering confirmed sales and supported by relevant documents like the bill of lading, post parcel receipts etc.

b. *Advance Against Export Bills Sent for Collection*- A commercial bank may provide finance by way of advance against export bills forwarded through it for collection after taking into account appropriate margin.

c. *Advance Against Duty Drawbacks, Cash Subsidy etc.-* To help the exporters, banks advancer against duty drawbacks, cash subsidy, etc., receivable by them i.e., exporters against their exports. Since such advances are clean in nature, the bank providing finance in this way generally insists that the relative export bills are either negotiated or forwarded for collection through it so that it can verify the exporter's claims for duty drawback, cash subsidy etc. such advance, short term in nature, is repayable within 180 days from the date of shipment of goods.

THUS, PRE SHIPMENT FINANCE- It is the finance required by the exporter for the purpose of purchasing, processing, manufacturing, packing and shipping the goods destined for export. It is in fact short term working capital finance.

THUS, POST SHIPMENT FINANCE -Loan or advance granted to an exporter from the time of shipment of goods to the time of realization

including against the security of duty draw back or any receivable from the govt.

11.10.1 Importance of export finance

"Export or perish" Our imports are more than exports. Hence there is a necessity to encourage exports. Govt. and RBI extend various concessions to boost exports.

Steps taken by Government of India to boost export finance-

Some of the concessions include:

a. Cheap credit to exporters.
b. Minimum of 12% of net credit should go to exports.
c. Refinance to Banks on eligible portion of export credit outstanding.
d. ECGC guarantee for export credits
e. No margin requirements for advance against export receivables.
f. Flexible approach to export lending and norms of lending.
g. Time norms for disposal of application for export credit.
h. Rejection with the concurrence of next higher authority
i. Bifurcation of WC limits into loan and cc component after excluding export limits.
j. Issue of Gold Card to exporters with good track record.

11.10.2 Exim Bank Finance

The Exim bank was set up to provide export and import finance to co-ordinate with others providing such finance and to promote the countries foreign trade. The bank has some borrowings from the central governments at a concessional rate of interest.

Presently the EXIM Bank has the following schemes of assistance:

a. Direct Financing of Exporters: It is provided to the Indian exporter so that he can in turn extend credit to overseas importers of capital goods made in India.

b. Financing of Export of technology and consultancy Services: It can also extend credit to the overseas importers.

c. Overseas Investment Finance: The EXIM Bank provides credit to the Indian exporter to enable him to finance his equity contribution in a joint venture abroad.

d. Overseas Buyer's Credit: The EXIM Bank provides the overseas buyer with deferred credit for purchase of Indian capital goods.

e. Lines of Credit: The Bank provides credit to the financial institutions, foreign Governments and agencies for 'On-Lending' to buyers for purchase of goods from India.

f. Refinance of Export credit: It provides refinance to commercial banks in India, authorized to deal in foreign exchange so that they can offer concessional finance to Indian exporters of Capital goods.

g. Export Bills Discounting: This facility is also provided to the commercial banks dealing in foreign exchange to enable them to fund Post-shipment export credit to Indian Exporters.

11.10.3 Forfeiting

Forfeiting has emerged as a popular method of finance export receivables. Basically it refers to non-recourse discounting of medium term (1-5 years) export receivables. The exporter here surrenders without recourse to him, his rights to claim for payment of goods delivered to an importer, in return for immediate cash payment from the forfeiter.

The advantages of forfeiting from exporters point of view are as follows:

a. It provides finance up to 100 percent of the export value as compared to 80-85%

b. It provides fixed rate finance. The exporter is protected from the interest and exchange rate risks arising from deferred export credit.

c. It relieves the exporter of credit administration and collection problems.

d. It does not impact the Exporters borrowing limits from banks.

Thus, forfeiting serves as an additional source of finance.



CHECK YOUR PROGRESS

Q12. Give two significance of Term Loans?

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Q13. Mention three Venture Capital Instruments.

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Q14. What is Export Finance?

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11.11 LET US SUM UP

In this unit, we have learnt about financial planning, its needs and importance. Various sources of short term finance.

Detail description of Capitalisation and its effect to various section of the society.

We have also gone through the various aspects of Term Loans and discussed about the function of venture Capitalists and various instruments of it.



11.12 FURTHER READING

1. Chandra Prasanna (2017); *Financial Management: Theory and Practice*;McGraw Hill Education; Ninth edition
2. I M Pandey (2016); *Financial Management;* Vikas Publishing House; 11th edition
3. Chandra Prasanna (2017); *Fundamentals of Financial Management*; McGraw Hill Education; 6 edition
4. M Y Khan (2017); *Financial management*; McGraw Hill Education; Seventh edition



11.13 ANSWERS TO CHECK YOUR PROGRESS

Ans to QNo. 1: The sources of finance are:

a. Long Term Finance
b. Medium Term Finance
c. Short Term Finance

Ans to QNo. 2: A Financial plan is a statement estimating the amount of capital and determining its composition.

Ans to QNo. 3: a. public deposits b. client
c. deferred incomes d. cheaper

Ans to QNo. 4: The capital structure of a company may consist of any of the following forms:

i. Equity Shares only
ii. Equity and Preferences Share
iii. Equity Shares and Debentures
iv. Equity Shares, Preferences Shares and Debentures.

Ans to QNo. 5: The important theories of capital structure are:

i. Net Income Approach
ii. Net Operating Income Approach

iii. The Traditional Approach

iv. Modigliani and Miller(MM)Approach

Ans to QNo. 6: The term loan is popularly used to denote the granting of an advance in lump sum, usually on the basis of some acceptable securities

Ans to QNo. 7: a. True b. False c. False d. True

Ans to QNo. 8: The application of planning in finance which is an important function of business is known as financial planning.

Ans to QNo. 9: Over - Capitalisation and Under - Capitalisation.

Ans to QNo. 10: Public deposits and Commercial banks.

Ans to QNo. 11: a. True b. False c. False d. True

Ans to QNo. 12: The two significance of Term Loans are:

a. It is an importance source of finance because of easy availability and its cheapness.

b. It satisfies the need of the borrower.

Ans to QNo. 13: Equity, Conditional Loans and Partially Convertible Debenture

Ans to QNo. 14: Export finance is to finance the Export Receivables.



11.14 MODEL QUESTIONS

1. What is financial planning?
2. Explain the various sources of Finance?
3. Point out the differences between over and Under Capitalisation.
4. What is Pre-Shipment and Post –Shipment Finance?
5. Write a note on Export finance and state its significance.

UNIT 12: FRANCHISING

UNIT STRUCTURE

12.1 Learning Objectives

12.2 Introduction

12.3 Definition of Franchising

12.4 Classification of Franchising

12.5 Features of Franchising

12.6 Types of Franchising

12.7 Advantages of Franchising

- 12.7.1 The advantage to the Franchisee
- 12.7.2 The advantage to the Franchisor

12.8 Disadvantages of Franchising

- 12.8.1 The disadvantages to the franchisee
- 12.8.2 The disadvantages to the Franchisor

12.9 The Franchise Agreement

12.10 Franchising in India

12.11 Laws regarding Franchising

12.12 Let Us Sum Up

12.13 Further Reading

12.14 Answers To Check Your Progress

12.15 Model Questions

12.1 LEARNING OBJECTIVES

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

- describe the concept of franchising
- discuss the ways franchising can be used
- explain the franchising agreement
- explain the effect of capitalisation
- have a detailed idea about venture capital and export finance.

12.2 INTRODUCTION

In this unit we are going to discuss on concept of franchising, its features and types. Franchising is a business system in which a Parent

Company grants selected retailers the right to sell its goods or services to use certain products, names or brands or to manufacture certain products.

In simple terms, it is the granting of certain rights by one Party (the franchisor) to another (the franchisee) in return for a sum of money. The franchisee then exercises those rights under the guidance of the franchisor.

Again at the end of this unit, we will get a fair idea on Franchising Agreement, Laws regarding Franchising, Franchising in India.

12.3 DEFINITION OF FRANCHISING

According to David .D. Settz, " A Franchise is a form of business ownership created by contract whereby a company grants a buyer the right to engage in selling or distributing its products or services under a prescribed business format in exchange for royalties or share of profits. The buyer is called the Franchisee and the Company that sells rights to its business concept is called the Franchisor."

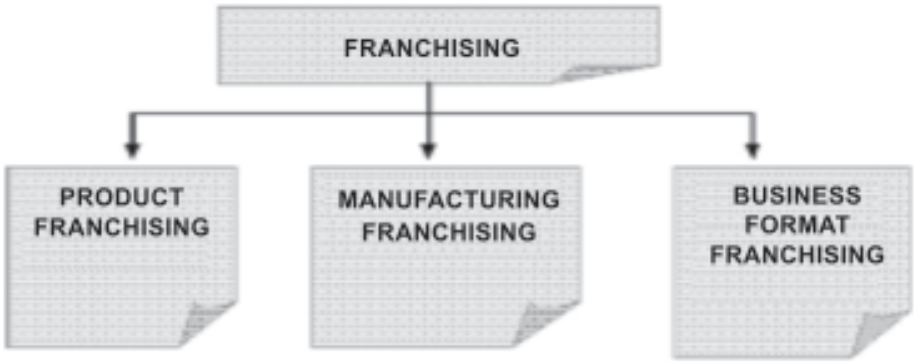
In crude commercial terms the reason for both the franchisor and franchisee entering into a contractual relationship with each other is to make a profit. The franchisee makes a profit from supplying the goods or services to the customer. The franchisor makes it from allowing the franchisee to use its package of know-how and intellectual property rights. There is a written agreement between the franchisor and the franchisee which lays down the terms and condition of sale by the franchisee. A franchisor can have arrangements with more than one franchisee to increase sales. The popular example of franchise stores are Mc. Donald (Fast food chains), Liberty (Shoe Stores) and NIIT (computer Centre).

The terms and conditions of the contract vary widely, but usually the franchisor offers to maintain a continuing interest in the business of the franchisee in such areas as location, site selection, training of staff, marketing, record keeping, and promotion. The franchisor also allows the use of the brand or trade name, window display, standardized operating procedure etc. to the franchisee. In return the franchisee is

eager to operate under the conditions set forth by the franchisor. For the help and services provided the franchisee makes a capital investment in business and he also agrees to pay a specified fee or commission or royalty. The real beauty of franchising is its adaptability. There are a number of classic forms of franchising which are usually sufficient to meet most demands. However, there are always some situations that present new challenges. Franchising can usually be adapted to meet these.

12.4 CLASSIFICATION OF FRANCHISING

Franchising arrangements are broadly classified into three types. There are; (a) product franchising (b) Manufacturing franchising (c) Business franchising



a. *Product franchising* is very popular in the petroleum and automobiles industries.

b. *Manufacturing franchising* is popular in food and beverage industry.

c. *Business format franchising* is a recent type of franchising and is the most popular one at present. It provides wide range of services to the franchisee including training, advertising, planning, etc.

12.5 FEATURES OF FRANCHISING

The salient features of Franchising are as follows:

1. **Written agreement:** The agreement between the Franchisor and the franchisee must be in writing.
2. **Transfer of right:** Franchising is a right transferred by the franchisor to the franchisee to use or sell a product or service.
3. **Area of operation:** The area is specified by the franchisor.
4. **Renewal contract:** A franchising contract is not a continuing contract. It is subject to termination and renewal.
5. **Consideration:** Franchising agreement is always made on payment of a consideration to acquire the right. A franchisee has to pay 'security money' or license fee at the time of contract and then a regular fee.
6. **Appointment of franchisee:** A franchisor can appoint more than one franchisee to increase sales.
7. **Imposing of restriction:** A number of restrictions are imposed upon the franchisee by the franchisor. The franchisor exercises a high degree of control over the franchisee.



CHECK YOUR PROGRESS

Q1: What are the three types of franchising?

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Q2: Discuss four features of franchising?

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12.6 USES OF FRANCHISING

In simple terms there are four ways in which it can be used.

1. **Creation of a new business specifically for franchisors:** An entirely new product or service can be created specifically for franchising. This has been done with businesses such as Snappy Snaps in the UK - which provides 1 hour film processing services and retails associated products such as picture frames and the like in the high street. Dub check is another example; it operates a contract cleaning business. Very often a local businessman identifies a successful franchised concept in another market such as the USA, and decides to create a similar concept in his own jurisdiction.
2. **Development of an existing business:** This is perhaps the most usual way of evolving a franchise. An existing product or service is further developed by use of the franchising method. Such businesses include the Dyne-rod drain cleaning business, the restaurant businesses and so on.
3. **Conversion of existing business to the franchise format:** Sometimes an established business can decide to convert its managed outlets to franchised outlets. The Thresher off-license chain in the UK is a good example of this. Such decisions are usually taken because of a desire to accelerate growth and reduce overheads without sacrificing quality control.
4. **Importation:** This is a very common method of evolving a franchise in the specific territory. The United States is the great exporter of franchise concepts around the world. Brands such as KFC, Holiday Inns, Hilton Hotels, Pizza Hut and McDonalds are all American exports. Body Soap is an example of a British franchise that has established itself around the world.

12.7 ADVANTAGES OF FRANCHISING

Advantages of franchising can be classified as:

a. Advantages to franchisee b. Advantages to franchisor

12.7.1 The advantage to the Franchisee

1. **Easy entry to business:** Buying a franchise is easier and safer than trying to start a business. The franchisee gets an already market tested business format from the franchisor.
2. **Recognition:** A well- established franchise brings with it the very important advantage of recognition. The franchisees can encash the brand name of the franchisor and in the process can make commercial gain.
3. **Proprietor of own business:** The franchisee is the proprietor of its own business and owns the tangible assets of the franchise outlet. Like any other business proprietor the franchisee buys materials, pays rent and staff salaries and takes the profit of operation, less royalty and service fees.
4. **Better Negotiation:** With the backing of a known trading name of the franchisor, the franchisee finds himself in a better position to negotiate successfully with third parties. Subject to various restrictions, it can sell its business when it wishes (usually subject to the franchisor's pre-emption right and on condition that the purchaser is approved by the franchisor). And also because of the goodwill or reputation of the franchisor, there are better prospects of obtaining loan facilities by the franchisee.
5. **Assistance and guidance:** A franchisee gets promotional, technical and managerial assistance from the franchisor. It gains from the franchisor the entire business concept with full training, assistance in every aspect of setting up and

running the business, and access to necessary materials and supplies.

6. **Less chances of failure:** It can be said that the franchisee does not have to worry about what to do or how to do it, but merely follow the developed concept and a well- tested franchise reduces the chances of failure.

According to the UK's Department of Employment over 25% of ordinary businesses fail whilst the BFA (British Franchising Association) quotes the failure for only 5% of franchised outlets.

12.7.2 The advantage to the franchisor

1. **Increasing outlets:** The main advantage of franchising to the franchisor is that it allows the latter to increase its number of outlets with minimum capital outlay and so accelerate the network's growth and probably its profitability.
2. **Expansion of business:** A franchisor can expand his market by appointing franchisees and in that case he need not incur any expenditure in the form of opening new branches. Self-employed franchisees are generally more highly motivated than salaried managers, and are more likely to produce better results for less expenditure of capital on behalf of the franchisor.
3. **Less staff:** Less staff will mean fewer personnel problems. As the franchise network grows it will become easier to handle national or regional customer accounts.
4. **Source of income:** The franchisor receives non –refundable ‘security money’ or license fee as initial consideration and regular royalty.
5. **Wider acceptability:** The franchisor gains wider acceptance of its brand name through the franchisees.
6. **Benefit of feedback:** The franchisor can get the pulse of the market that is the consumer’s tastes, preferences, etc. through the franchisees.

7. **Controlling power**: Under franchising agreement the franchisor is allowed to exert real control over the franchisees. The franchisor can exercise a high degree of control over the franchisee.



CHECK YOUR PROGRESS 2

Q3: Fill in the blanks

a. KFC, Pizza Hut and McDonalds are all ..... exports

b. The franchisee is the …….. of its own business

c. A franchisee gets promotional, …….. assistance from the franchisor

d. BFA stands for……

Q4: What are the uses of franchising?

.....

.....

.....

.....

12.8 DISADVANTAGES OF FRANCHISING

Disadvantages of franchising can be classified as:

a. Disadvantages to franchisee

b. Disadvantages to franchisor

12.8.1 The disadvantage to the franchisee

1. The franchisee is not an independent entrepreneur. In the final analysis the franchisee must follow the franchisor's instructions.
2. The lower risk is off-set by the lower reward for success.
3. A number of restrictions imposed by the franchisor may relate to remain confined to product line.
4. They find no room or scope for enjoying their creativity.

5. The franchisee usually does not have the right to transfer his business to a member of his family without the approval of the franchisor.
6. Constant fear of non- renewal of franchise agreement because the franchisor reserves the option to buy back an outlet upon termination of the contract.

12.8.2 The disadvantage to the franchisor

1. The disadvantage of franchising to the franchisor is that it has to control and co-ordinate a network of semi-independent businessmen and has ensures that they build and maintain a favorable image for the whole franchised operation. This means that the franchisor's own role changes drastically.
2. The policing and monitoring of standards by the franchisor is vital but can at times be difficult.
3. The franchisor will sometimes have to resort to the use of both carrot and stick to get franchisor to try new techniques or improve their current performance.

12.9 THE FRANCHISE AGREEMENT

The following comments generally apply not only to unit franchises but also to development and master franchise agreements, unless expressly stated otherwise.

1. **The Grant:** A franchise involves the franchisor in granting the franchisee certain rights over a certain area for a specified period. Exactly what those rights, the area and period are is a matter of negotiation between the franchisor and the intending franchisee. Little, if anything, is open to negotiation with domestic franchising.

2. **System and intellectual property rights:** Any franchise agreement must permit the franchisee to use the franchisor's system together with its name and trade marks. Clauses protecting this intellectual property and ensuring that the franchisees do not abuse it.

3. **Territory:** It is usual for the franchisee to want as large an area

as possible so as to give it the largest possible return on its investment. The franchisor, however, must only decide upon what territory it is willing to grant after taking account of a number of criteria concerning the territory and the franchisee.

The territory should be one geographical, political, cultural and economic unit, which allows a planned approach to development of the franchise. The geographical distance, cultural and political differences need to be taken into account when deciding upon the size of the territory. Inadequate resources will by necessity mean that the whole territory will not be systematically exploited and will be limited, not by the suitability of the system to the territory, but by the franchisee's inability to properly expand it. It is therefore necessary to vet carefully the potential sub-franchisor/developer by way of bank and trade references and company searches.

Incorporation of any business plan into the development schedule will help encourage a realistic approach to it by the franchisee and so enable the franchisor to gauge its resources more accurately.

4. **Exclusivity:** The franchisee will inevitably demand exclusivity in order to give it the comfort of knowing that it will not be in competition with a third party and that its investment is more secure. From the franchisor's point of view, exclusivity should not be objectionable so long as the franchisee has been properly vetted, the size of the territory sensibly decided and a proper development schedule agreed upon.

5. **Term and renewal:** It is common, but by no means universal, for franchisee agreements to be granted for a period of between five and ten years. Such a term is thought to be necessary in order for the franchisee to obtain a decent return on its investment. Generally, the grant of such a term is neither controversial nor legally difficult. In some jurisdictions however, there is a restriction imposed by the government upon the maximum possible term.

   However, problems are common over the often vexed question of renewal and what happens to franchisees in the event of non-

renewal. There are various schools of thought on these issues but the reality is that by and large, international business format franchising is still in its infancy and the problems involved in renewal and non-renewal have not yet to be faced by many international franchisors.

The most difficult problem relates to the terms being granted to franchisees. Usually franchisees will be granted an automatic right of renewal subject to there being no existing breach and the franchisee updating its outlets as required by the sub-franchisor.

6. **Key man:** It may be that the franchisor is making the grant to the franchisee mainly because of the personal attributes of one of its key employees. In such a case it is essential that the agreement stipulates clearly the importance of that individual's role in the scheme of things. It is also vital that the grant is made conditional on the continued efforts and employment of that individual by the franchisee. Termination of the key man's full-time employment in the franchise should be a material breach of the terms of the grant and be grounds for termination.



CHECK YOUR PROGRESS

Q5: State True or False

a. ..... The franchisee is an independent ..... entrepreneur.(T/F)

b. Franchisee agreements are granted for a period of between five and ten years.(T/F)

Q6: What are the main criteria for franchise agreements?

.....

.....

12.10 FRANCHISING IN INDIA

Franchising is in its early stages in India, but has become increasingly popular as a means of doing business in the past few years, both in terms of international franchises and domestic ones. As

a result, the Franchising Association of India was set up in Mumbai, in 2000 which has links with other such associations around the world. The Franchising Association is still considering whether it should have a Code of Conduct or whether they should press for specific legislation in relation to franchising. The difficulty with a Code of Conduct is that not all franchisors and franchisees are the members of the Association and it is difficult to enforce.

Regarding the background it can be said that, international soft drink and hotel franchises arrived in India as early as in the 1960s, but in 1977 the Government of the day had expelled foreign brands from India. The foreign brands started returning gradually from the mid '80s.

In the 1990's as the market opened, foreign franchises started coming in gradually, but had to face many hiccups along the way, especially KFC, Schweppes etc. Since then there has been progressive entry of international franchises of which, some have been successful and others not so fortunate. The well-known franchises relating to soft drinks, ice-cream parlors or restaurants include Pepsi, Coke, Baskin Robbins, Move pick, Subway, McDonalds, TGIF, Geoffrey's, Taco Bell, Pizza Hut, Pizza Piazza, Dominos Pizza, O'Brian's Sandwich Bar, Ruby Tuesdays and Barista. Retail franchises include Marks & Spencer, West Side, Vita Perini, Peep Jeans and Adams. Courier companies like Air Action and DHL are there along with computer and software related franchises. The Government has liberalized the rules and regulations in relation to the retail industry and a boom in this sector is on its way.

Franchising has also become a popular method of doing business within India with the franchisor granting numerous unit franchises in a wide range of areas. This has been the case in respect of IT education and franchises such as APTEC, NIIT, and STG. Then there are local food chains like Chawla's, Nirulas, Nilgiris, Coffee Day, Café Nescafe, and Sagar Ratna. Health clubs like VLCC have come up along with hair and beauty parlours who often sell their products like Shanaz Hussein, Biotique and Habibs. There are numerous cargo and courier companies like Blue Dart, ADL, Dartmail, Blaze Flash, First Flight, Professional

Couriers and DTDC. Clothing retail outlets especially for designer clothing include Bentley, L.F Couture, Ritu Beri and Deewan Sons. Other retail chains include Shopper's Stop, Lifestyle and Ebony. There are Indian travel agencies which now want to franchise abroad like Uniglobe or expand locally like Travel Port. Now the major area for local franchises seems to be healthcare with Apollo Hospitals and various diagnostic centres. Shanaz Hussein beauty saloons and products is already an international franchise, and slowly other Indian franchisors are likely to look to expand internationally with the easing of restrictions by the Government especially since 2000.

It took some time for international franchises to become acceptable because of certain attitudes of Indian businesses towards foreign franchises whereby they could not understand why the Indian party had to make all the investments in India and on top of that had to make hefty payments in foreign exchange to the Master franchisor. Indians feel the foreign franchisor or business should also invest, participate and have some interest in the development and success of the entire business. If the brand name is very well known world wide and the product is marketable in India, then the attitude can significantly change, as it is obvious that the local business would profit just by riding on the back of a well known brand. If the brand is well known in another country but not in India or to Indians travelling abroad, then it is difficult to convince an Indian businessperson to pay lump sum payments or royalties as its worth is not the same in India. That again can be overcome if the product or service provided by the franchise is in short supply in the country and important to its development. Market research and pilot projects can assist in assessing the prospects of any international franchise in India.

The lower the price a product or service can be sold at, the more customers they are likely to attract. Some products may be designed to appeal to the masses and other high price items can be marketed just for a select clientele like those in big business, professions, the film industry or celebrities.

Expensive cosmetics and beauty therapy from abroad is for the latter. The needs of the affluent has been met already with many expensive products in the market, however there is still scope in the retail sector for cheaper goods in terms of clothing or cosmetics.

In the soft drink and fast food sector, Coke, Pepsi, McDonald and Pizza Hut have already captured the mass market.

In many instances the products sold by the franchise outlets may have to be suitably tailored to local taste, which may go against the franchising concept or principle .In such cases the outlets should be identical, and a customer should find identical quality of goods. If one goes to a McDonalds or TGIF or Pizza Hut in India, the food tastes different and the menus are geared to local taste and culture. For instance, people like spicy food, and beef and pork have to be absent in the menu to avoid offending religious sentiments. In relation to Restaurants and pubs, even if families would like to go together, the licensing laws in many states prohibit the entry of persons less than 21 years to go to an eating place or restaurant where liquor is sold. Regarding the retail franchises involving clothing, the children's wear and men's wear are similar to those in any other western country except that the material has to suit the tropical climate and relatively milder winters. The women's fashion, however, is significantly different with the majority wearing salwar kameez or saris. Western clothes like suits, trousers, skirt and tops for women are becoming popular among teenagers and women in cosmopolitan areas of large cities.

12.11 LAWS REGARDING FRANCHISING

There is no specific legislation or rules applicable to franchising. There is considerable discussion going on now on whether disclosure laws should be introduced. It is advisable that parties disclose and exchange information on each other and due diligence is carried out before entering into a formal agreement.

There are remedies, however, under the Indian Contracts Act and Specific Relief Act for breach of contract or misrepresentation.

It is also advisable that the franchise is structured in such a manner that it fits around the rules and regulations and also best protects the interests of the parties. There are several Governmental permissions that would be required before an international master franchise can be granted in India. Payments for Master franchisors are best spread out between lump sum fees, royalties, consultant's fees, and design and engineering fees.

One needs to check the areas where incentives are given by the Government in terms of allowing more foreign shareholding, tax breaks and royalties. It is often in the area in which franchises exist, like in the hotel and tourism industry.

In relation to opening outlets in various parts of India, it is necessary to check the state and local laws relevant to the town or city.

The new Competition Act 2002 is aimed at promoting free trade and ending protectionism. The main areas that are dealt with by the Act are: the prohibition of anti-competitive agreements; prohibition of abuse of dominant position and regulation of combinations. This prohibits the franchisors and franchisees from entering into agreements, such as those involving tied sales, price fixing and other monopolistic trade practices. This Act interprets agreements in a very wide sense including all kinds of arrangements and understanding whether formal or informal, written or oral which has the desired effect, whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

For Indian master franchisors seeking to expand to other countries, significant positive changes have been made since the Foreign Exchange Regulation Act 1973 was replaced by Foreign Exchange Management Act 2000 and rules made under it. Still permissions have to be sought under the latter before doing business abroad and there are limits or caps regarding the foreign exchange available. It is much easier for Indian companies who are earners of foreign exchange and those that have foreign branches or subsidiaries.



CHECK YOUR PROGRESS

Q7: State True or False

a. The Franchising Association of India was set up in Mumbai in 2001. (True /False)

b. The well-known franchises relating to soft drinks include Pepsi, Coke. (True /False)

c. The new Competition Act 2002 is aimed at promoting free trade and ending protectionism. (True /False)

d. Foreign Exchange Regulation Act 1973 was replaced by Foreign Exchange Materials Act 2000. (True /False)



12.12 LET US SUM UP

In this unit we have learnt about how franchising is becoming popular as a means of doing business. We come to know about the pros and cons of the parties i.e. the franchisor and franchisee.

We also learn about the Franchising Agreement explaining the rights of the Franchisee, the Terms and other rules and regulations.

The chapter consists of the ways being explained about how Franchising can be used, and the ways it can be developed.



12.13 FURTHER READING

1. Business Organization and Entrepreneurship Development- By Sharma and Gupta
2. General Magazines for Business purpose.



12.14 ANSWERS TO CHECK YOUR PROGRESS

Ans to QNo. 1: Franchising classified into three types:

a. Product franchising

b. Manufacturing franchising

c. Business franchising

Ans to QNo. 2: Features of Franchising are as follows:

a. Written agreement

b. Transfer of right

c. Area of operation

d. Renewal contract

Ans to QNo. 3: a. American b. Proprietor

c. technical and managerial d. British Franchising Association

Ans to QNo. 4: There are four ways in which franchising can be used:

a. Importation

b. Creation of a new business specifically for franchisors

c. Development of an existing business

d. Conversion of existing business to the franchise format

Ans to QNo. 5: a. False b. True

Ans to QNo. 6: The main criteria for franchise agreements are as follows:

a. Key man

b. System and intellectual property rights

c. Territory

d. Exclusivity

e. Term and renewal

f. The Grant

Ans to QNo. 7: a. False b. True c. True d. False



12.15 MODEL QUESTIONS

1. Define Franchising. What are its features?
2. Explain the different types of Franchising?
3. Write a note on Franchising in India.
4. Point out Five Advantages of Franchising to the Franchisor.
5. Point out Five Disadvantages of Franchising to the Franchisee.
6. What is the significance or importance of Franchising?
7. Discuss the laws relating to franchising?

UNIT 13:INDUSTRIAL FINANCE TO ENTREPRENEURS

UNIT STRUCTURE

13.1 Learning Objectives

13.2 Introduction

13.3 Concept of Commercial bank

13.4 Concept of other development financial institution.

- 13.4.1 Industrial Development Bank of India (IDBI)
- 13.4.2 Industrial Reconstruction Bank of India (IRBI)
- 13.4.3 Life Insurance Corporation of India (LIC)
- 13.4.4 State Financial Corporations (SFCs)
- 13.4.5 State Industrial Development Corporations (SIDC's)
- 13.4.6 Small Industries Development Bank of India (SIDBI)
- 13.4.7 Export Import Bank of India (EXIM BANK)
- 13.4.8 National Bank for Agriculture and Rural Development (NABARD)
- 13.4.9 Industrial Finance Corporation of India Ltd. (IFCI)
- 13.4.10 Unit Trust of India (UTI)

13.5 Let Us Sum Up

13.6 Further Reading

13.7 Answers To Check Your Progress

13.8 Model Questions

13.1 LEARNING OBJECTIVES

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

- explain the types of financial assistance provided by commercial banks to the small entrepreneurs
- list the various financial institutions which provide financial assistance with the types of assistance to the entrepreneurs in the country.

13.2 INTRODUCTION

In this unit we are going to discuss about, how other financial institutions provide financial assistance to entrepreneurs. We have

discussed about different financial institutions like, IDBI, IRLI, LIC, SIDBI, NEDFI, NABARD etc. These institutions provide financial assistance and guidance to different small scale entrepreneurs. Government also provides various supports to such entrepreneurs. This unit will explain the functioning of commercial bank and different financial institutions.

13.3 CONCEPT OF COMMERCIAL BANK

The Scheduled Commercial Banks (SCBs) in the country (288) comprise the State Bank of India (SBI) and its associated banks (8), nationalised banks (19), private sector banks (32), regional rural banks (RRBs) (196) and foreign banks (23). During 1994-95, ten more banks were given the status of SCBs and one, viz. Bank of Karad which was taken over by Bank of India was excluded. As on March 31, 1995, the total number of branches of SCBs stood at 62,067, of these 35,060 (56.5% of the total) were in rural areas. The commercial banks started taking initiation in financing SSIs in a greater way only after the bank nationalisation in July 1969. Normally, the commercial banks provide assistance for working capital requirements of SSIs. A notable feature in the financing of SSIs has been the introduction of the 'Lead Bank Scheme' by the RBI. Under this scheme, each district has been allotted to one scheduled commercial bank for intensive development of banking facilities.

The introduction of 'Credit Guarantee Scheme', in 1960, was a big fillip in the field of commercial bank financing to SSIs. Initially, this scheme was introduced in 22 districts on experimental basis. Later, it was extended to all over the country. Based on the recommendations of the Committee, the RBI introduced a special package of measures for financing SSIs and advised banks to take various measures aimed at increasing the credit flow to the SSIs and arresting the problem of sickness in small-sector.

13.4 CONCEPT OF OTHER FINANCIAL INSTITUTIONS

13.4.1 Industrial Development Bank of India (IDBI)

V.V. Bhatt rightly pointed out that the country needed a central development banking institution for providing "dynamic leadership in the task of promoting a widely diffused and diversified and yet viable process of industrialisation"2. It was to fulfil this objective, the Government decided to establish the Industrial Development Bank of India (IDBI). The IDBI was established on July 1, 1964 under the Act of Parliament as the principal financial institution in the country. Initially, it was set up as wholly owned subsidiary of the Reserve Bank of India. In February 1976, the IDBI was made an autonomous institution and its ownership passed on from the Reserve Bank of India to the Government of India.

The IDBI provides assistance to the small-scale industries through its scheme of refinance and, to a limited extent, through its bills rediscounting scheme. In 1988, the IDBI also launched the National Equity Fund Scheme (NEFS) for providing support in the nature of equity to tiny and small-scale industries engaged in manufacturing, cost not exceeding Rs. 5 lakhs. The IDBI has also introduced the single window assistance scheme for grant of term loans and working capital assistance to new, tiny and small scale enterprises. Last but no means the least, the IDBI has also set up a Voluntary Executive Corporation Cell (VECC) to utilize the services of experienced professionals for counseling small units, tiny and cottage units and for providing consultancy support in specific areas.

In order to make the IDBI's co-ordinating role more effective, the Narasimham Committee has suggested that the IDBI should give up its direct financing function and perform only promotional apex and refinancing role in respect of other institutions like SFCs and SIDBI, etc.

13.4.2 Industrial Reconstruction Bank of India (IRBI)

The Government of India set up the Industrial Reconstruction Corporation of India (IRCI) in April 1971 under the Indian Companies

Act mainly to look after the special problems of 'sick' units and provide assistance for their speedy reconstruction and rehabilitation. In August 1984, the Government of India passed an Act covering the Industrial Reconstruction Corporation of India (IRCI) into the Industrial Reconstruction Bank of India (IRBI). The IRBI has to function as the principal all-India credit and reconstruction agency for industrial revival, assisting and promoting industrial development and rehabilitating industrial concerns.

Formerly IRCI had extended assistance to sick closed industrial units in textiles, engineering, mining and foundary industries. Now IRBI extends assistance to sick small-scale units also.

The IRBI had diversified its activities into ancillary lines such as consultancy services, merchant banking and equipment leasing. All these activities are allied to its task of rehabilitation of sick industrial units. Through its consultancy services, IRBI attempts to help banks and financial institutions to assess intrinsic worth of sick units which are seeking assistance for revival. Through its merchant banking services, IRBI enables units in the process of amalgamation, merger and reconstruction. Equipment leasing was, in fact, an extension of the IRBI hire-purchase scheme.

13.4.3 Life Insurance Corporation of India (LIC)

The Life Insurance Corporation of India (LIC) was established under the LIC Act in 1956 as a wholly-owned corporation of the Government of India, on nationalisation of the life insurance business in the country. LIC offers a variety of insurance policies to extend social security to various segments of society. It has been deploying its funds in accordance with plan priorities.

As per its investment policy it invests 75% and above of the accretion to its Controlled Fund in Central and State Governments' securities including government-guaranteed marketable securities and in the socially oriented sectors. It also provides loans for various purposes like housing, water supply, rural electrification,

etc. to benefit individuals and groups. LIC also provides term loans and underwriting/direct subscriptions to shares and debentures of corporate sector

During 1994-95, assistance sanctioned to corporate sector stood at Rs. 113 crore. The private sector claimed the higher share (57.8%) in total sanctions. It was distantly followed by public sector (34.1%) and co-operative sector (8%). As regards the purpose-wise assistance sanctioned, the new projects claimed maximum share of 37.3% in total sanctions, followed by expansion/ diversification (31.2%) and modernisation/ rehabilitation/balancing equipment (12.4%).

13.4.4 State Financial Corporations (SFCs)

The Industrial Finance Corporation of India (IFCI) set up in 1948 used to provide financial assistance to only large-sized industrial undertaking. In order to cater the financial requirements of a large number of small-scale units, the State Financial Corporation Act was passed by the Parliament on September 28, 1951 under which the State Financial Corporations (SFCs) could be set up. The first SFC was set up in Punjab in 1953. Today, there are in all 18 SFCs in the country which exist almost in every State and Union Territory (UT) of the country. Of these 17 are set up under the SFCs Act, 1951. The Tamil Nadu Industrial Investment Corporation Ltd., established in 1949 under the Companies Act as Madras Industrial Investment Corporation, also functions as a full-fledged SFC. The management of the State Financial Corporation is similar to that of the IFCI. It has a board of directors, a Managing Director and an Executive Committee. An SFC can open its offices at different places within the State.

The main functions of SFCs has been to provide long-term finance to small and medium sized industrial units organised as proprietary, partnership, co-operative, public or private company concerns. Its other functions are to undertake the issue of stock, shares, bonds

or debentures of industrial concerns and to grant loans and advance to industrial concerns repayable within a period not exceeding 20 years. They also subscribe to debentures floated by the industrial concerns. SFCs also grant financial assistance to small road transport operators, hotels, tourism-related activities, hospitals and nursing homes, etc.

13.4.5 State Industrial Development Corporations (SIDCs)

The State Industrial Development Corporations (SIDCs) were incorporated under the Companies Act, 1956, in the sixties and early seventies as wholly-owned State Government Undertakings for promoting industrial development.

The main functions of SIDCs are to provide assistance in the form of term-loans, underwriting direct subscription to shares/ debentures and guarantees. They also under¬take a variety of promotional activities like preparation of feasibility reports, conducting industrial potential surveys, entrepreneurship development programmes and developing industrial estates. Some SIDCs also offer a package of developmental services such as technical guidance, assistance in plant locations and co-ordination with other agencies. In line with the changing environment, many SIDCs are making efforts to diversify and entering into the fields of equipment leasing, merchant banking, venture capital and mutual funds.

There are 28 SIDCs in the country. Aggregate to assistance sanctioned by all SIDCs during 1994-95 amounted to Rs. 1511 crore and disbursements accounted for Rs. 984 crore.

13.4.6 Small Industries Development Bank of India (SIDBI)

With a view to ensuring larger flow of financial and non-financial assistance to the small-scale sector, the Government of India set

up the Small Industries Development Bank of India (SIDBI) under a special Act of the Parliament in October 1989 as a wholly-owned subsidiary of the IDBI. The Bank commenced its operations from April 2, 1990 with its head office in Lucknow. The SIDBI has taken over the outstanding portfolio of the IDBI relating to the small-scale sector worth over Rs. 4,000 crores. The authorised capital of SIDBI is Rs. 250 crores with an enabling provision to increase it to Rs. 1,000 crores.

The important functions of SIDBI are as follows:

(1) To initiate steps for technological upgradation and modernisation of existing units.

(2) To expand the channels for marketing the products of SSI sector in domestic and international markets.

(3) To promote employment oriented industries especially in semi-urban areas to create more employment opportunities and thereby checking migration of people to urban areas.

The year wise sanctions and disbursement made by the SIDBI since its establishment are :

Assistance Sanction and Disburse

(Rs. Crore)

Year	*Sanctions*	*Growth Rate%*	*Disbursements*	*Growth Rate%*
1990-91	2408.7		1838.5	
1991-92	2846.0	18.2	2027.4	10.3
1992-93	2908.4	2.2	2145.8	5.8
1993-94	3354.1	15.3	2671.3	24.5
1994-95	4699.3	40.1	3385.3	26.7
Cumulative up to end-March1996	16216.4		12068.2	

13.4.7 Export-Import Bank of India (EXIM Bank)

The Export-Import Bank of India, commonly known as the EXIM bank, was set up on January 1, 1982 to take over the operations of the international finance wing of the IDBI and to provide financial assistance to exporters and importers to promote India's foreign trade. It also provides refinance facilities to the commercial banks and financial institutions against their export-import financing activities.

The important functions of the EXIM Bank are as follows:

(1) Financing of exports and import of goods and services both of India and of outside India.

(2) Providing finance for joint ventures in foreign countries.

(3) Undertaking merchant banking functions of companies engaged in foreign trade.

(4) Providing technical and administrative assistance to the parties engaged in export and import business.

(5) Offering buyers' credit and lines of credit to the foreign governments and banks.

(6) Providing advance information and business advisory services to Indian exporters in respect of multilaterally funded projects overseas.

With a view to promote, exports, EXIM Bank has introduces three schemes. These are :

(i) Production Equipment Finance Programme.

(ii) Export Marketing Finance.

(iii) Export Vendor Development Finance.

13.4.8 National Bank for Agriculture and Rural Development (NABARD)

NABARD provides industrial finance by way of refinance for artisans, village and cottage industries and other allied activities. It provides accommodation to state co-operative banks for financing

apex regional weaver's societies in marketing or working capital for procurement of cloth. Refinance facility is also provided for financing working capital requirements of wire-making co-operatives in Kerala. NABARD provides refinance to financial institutions under the Integrated Rural Development Programme (1RDP). It also provides refinance to banks against their term lending for seri-agricultural activities comprising cultivation, rearing of cocoons and purchase of appliances. NABARD also has a Soft Loan Assistance Fund Scheme to provide margin money to the prospective entrepreneurs.

13.4.9 Industrial Finance Corporation of India Ltd. (IFCI)

The Government of India set up the Industrial Finance Corporation of India (IFCI) under IFCI Act in July 1948. Since July 1,1993, it has been brought under Companies Act, 1956. The IFCI extends financial assistance to the industrial sector through rupee and foreign currency loans, underwriting/direct subscriptions to shares/ debentures and guarantees and also offers financial services through its facilities of equipment procurement, equipment finance, buyers' and suppliers' credit, equipment leasing and finance to leasing and hire-purchase companies. It also provides merchant banking with its Head Office in Delhi and a bureau in Bombay.

The financial resources of the IFCI are constituted of the following three components: (i) Share capital, (ii) Bonds and Debentures; and (iii) Other Borrowings. Its paid-up capital as on March 31, 1995 stood at Rs. 352 crore from an initial of Rs. 5 crore in 1948. The IFCI started its lending operations on a modest scale in 1948. The operations of the IFCI have grown over the years and so have its assistance. Assistance sanctioned by the IFCI during 1994-95, rose by 52.7% to Rs. 5719 crores. Assistance disbursed went up by 31.2% to Rs. 2839 crore during the year. Cumulatively, upto end-March 1995, the IFCI's sanctions amounted to Rs. 24,599 crore, while disbursements aggregated Rs. 15,387 crore.

In recent years, the IFCI has started new promotional schemes, such as (a) interest subsidy scheme for women entrepreneurs; (b) consultancy fee subsidy schemes for providing marketing assistance to small-scale industries; (c) encouraging the modernisation of tiny, small-scale ancillary units; and (d) control of pollution in the small and medium-scale industries.

No doubt, the IFCI has experienced impressive performance over the years. At the same time, it is also true that there are certain flaws in its functioning which have invited criticism from different quarters. To quote, the important ones are: (i) The IFCI's lending operations have encouraged concentration of wealth and capital. It still pursues a discriminatory policy to the disadvantage of medium and small-scale units, (ii) There are great delays in sanctioning loans and, then, making the amount of the loan available, (iii) The IFCI has failed to exercise necessary control over the defaulting borrowers.

13.4.10 Unit Trust of India (UTI)

The Unit Trust of India (UTI), established under an Act of Parliament in 1964, mobilizes savings of small investors through sale of units and channelises them into corporate investments. Over the years, the UTI has introduced a variety of schemes to meet the need of diverse sections of investors. The UTI also provides assistance to the corporate sector by way of term-loans and underwriting/ direct subscription of shares/ debet ures.

During the year 1994-95, the UTI launched nine new schemes/ plans aimed mainly at common investors. These, among others, included open-ended schemes like Grihlakshmi Unit Plan, Retirement Benefit Plan, Primary Equity Fund, Unit Scheme 1995 (targeted at corporate unvestors) and Columbus India Fund.

Overall assistance sanctions, during 1994-95, to corporate sector stood at Rs.7,677 crore and disbursement aggregated Rs.4,791 crore. About three-fourth of the sanctions were by way of

underwriting/direct subscription to shares and debenture. Cumulatively, up to end-March 1995, assistance sanctioned and disbursed by the UTI to corporate sector amounted to Rs. 39,642 crore and Rs. 29,285 crore respectively. During 1994-95, more than nine-tenth (90.4%) of the total assistance sanctioned by UTI was accounted for by private sector and the remainder (9.6%) by public sector. It is worth noticing that while private sector showed a marginal increase of 6.1% in sanctions, public sector experienced a big decline of 56.4%.



CHECK YOUR PROGRESS

Q1: State true/ false for the following statements:

a. Export Marketing Finance is one of the schemes of EXIM BANK. (True/False)

b. The IDBI provides assistance to the small-scale industries through its scheme of refinance. (True/False)

c. IFCI was set up under IFCI Act in July 1948. (True/False)

d. LIC was established under the LIC Act in 1958. (True/False)



13.5 LET US SUM UP

In this unit, we have discussed the following

- The small-scale entrepreneurs lack sufficient finance to run their enterprises, the Government has set up a number of financial institutions – both at the Central and State level.
- The important types of assistance are – term finance, refinance, working capital finance, export finance etc.

- The basic purpose of the assistances is to boost development of small-scale enterprises in the country.



13.6 FURTHER READING

1. B. Bhatnagar and A Budhiraja(2011), *Entrepreneurship Development & Small Business Management,* Vayu Education Of India
2. Khanka SS (2007), *Entrepreneurial Development*; S Chand & Company; Reprint Edn. 2006 edition
3. Scarborough and Cornwell (2016), *Essentials of Enterpreneurship & Small Business Management,*Pearson Education India; Eighth edition
4. Charantimath(2013), *Entrepreneurship Development and Small Business Enterprises*,Pearson Education India; Second edition
5. Pathak R.K. and Kalwar M.C.(), Business Organisation and Entrepreneurship Development



13.7 ANSWERS TO CHECK YOUR PROGRESS

Ans to QNo. 1: a. True b. True c. True d False.



13.8 MODEL QUESTIONS

1. Discuss the role of Industrial Development Bank of India in financing small enterprises in the country.
2. What are the main functions of SIDBI? Discuss the various types of assistances the SIDBI provides to small enterprises.
3. Why was EXIM BANK set up? Discuss the various types of

assistances the Bank provides to the entrepreneurs engaged in export and import business in India?

4. Give an account of financial assistance provided by the IFCI to small entrepreneurs/ enterprises in India.

UNIT 14 : SMALL ENTERPRISES IN INTERNATIONAL BUSINESS AND ELECTRONIC COMMERCE & SMALL UNITS

UNIT STRUCTURE

14.1 Learning Objectives

14.2 Introduction

14.3 Export promotion and trends of small enterprises

14.4 Concept of major constraints

14.5 Concept of export potentials of small-scale units.

14.6 Suggestions to improve exports

14.7 Meaning of e-commerce

14.8 Concept of evolution and growth

14.9 Benefits of e-commerce

14.10 Suitability of e-commerce for small units

14.11 Prospective areas for e-commerce

14.12 Challenges faced by e-commerce

14.13 Let Us Sum Up

14.14 Further Reading

14.15 Answers To Check Your Progress

14.16 Model Questions

14.1 LEARNING OBJECTIVES

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

- discuss the export promotion and trends of small enterprise
- analyze the major constraints faced by small enterprise in exporting their products
- explore the possibilities for increasing exports of small industry products
- describe suggestions for increasing exports of the products manufactured by small sector
- define e-commerce
- learn evolution and growth of e-commerce
- identify the benefits E-commerce

- identify the prospective areas of E-commerce in small enterprises
- explain the challenges E-commerce is presently facing in India.

14.2 INTRODUCTION

In this unit we are going to discuss the concept of export promotion and trends of small enterprises, and the major constraints faced by small enterprise in exporting their products. You will be able to know the possibilities for increasing exports of small industry products.

Again at the end of this unit you will be able to know about e-commerce in small enterprises, the challenges faced by e-commerce, Suitability of e-commerce for small units and benefits of e-commerce etc.

14.3 EXPORT PROMOTION AND TRENDS OF SMALL ENTERPRISES

Exports from small enterprises have been on increase registering an annual growth of about 171 per cent during 1978-94. One way to view at the impressive growth of exports from small enterprises in their increasing share year after year to the total exports from the country. The percentage share of small enterprise exports to the total from 1971-72 onwards is presented in the following Table.

Increasing Exports from Small Enterprises

(Rs. in crore)

Year	Total Exports	Export from Small Enterprises	Percentage 3 to 2
1	2	3	4
1971-72	1608	155	9.6
1976-77	5142	766	14.9
1981-82	7890	2071	26.5
1986-87	12567	3644	29.0
1991-92	44040	13883	31.5
1992-93	53688	17785	33.1
1993-94	69547	24149 (P)	34.5

It is interesting to note that the total exports of the country increased by about 43 times, while the exports from small enterprises increased by about 155 times. Small enterprises also make indirect exports through merchant exporters, trading houses, export houses and large enterprises. These indirect exports are estimated at around 10 per cent of the total exports. It is also expected to increase in further when the ongoing economic reforms in the country start giving results.

Though the growth of exports from the small enterprises is, no doubt, impressive, it is also true that India's share in world's exports is very low, at about 0.5 per cent. India is now the member of the World Trade Organization (W.T.O.). Hence, it has to improve its share in world's exports to be a global player.

14.4 CONCEPT OF MAJOR CONSTRAINTS

Among about 24 lakh registered and unregistered small scale units in the country, about 90 per cent units are tiny with an investment in plant and machinery upto Rs.5 lakhs. Technology is the crux of quality and competitiveness. But, many small scale units particularly tiny units find it difficult to go for modernization and technology upgradation because of low ceiling on investment in plant and machinery. According to the Second All India Census of Registered Small Scale Industrial Units, out of 5.82 lakh units working in 1987-88, the number of exporting units was 4,554 only, i.e., only 0.7 per cent of the total units.

The major constraints encountered by the small scale units in exporting their products are as follows:

a. **Credit Policy:** The Small scale units have very weak-base of their own funds, on the one hands, and has no access to other sources of funds like capital market, on the other. Hence, they have to depend upon the State Financial Corporation (S.F.C.s) and the commercial banks to meet their long-term and short-term capital requirements.

b. **Infrastructure:** Lack of infrastructure facilities like power supply, transportation and communication adversely affect the quantity and

quality of production, its costs and delivery. These, in turn, tell upon the export performance of small scale units.

c. **Technology:** Technology is the crux of quality and competitiveness. However, the adoption of technology in small industries hampered due to lack of infrastructure facilities, on the one hand, and the present investment ceiling of the small scale industry, on the other.

The recent telecommunication revolution has offered hi-tech application for market research which is more cost effective substitute for exploratory personal visits abroad. As a matter of fact, the conventional method of market explorations through trail and error and private contacts has been replaced by the electronic network exchanging business queries between the trading parties.



CHECK YOUR PROGRESS

Q1: What are the constraints encountered by small scale units in exporting the products?

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14.5 CONCEPT OF EXPORT POTENTIAL OF SMALL SCALE UNITS

The small units are inherently flexible to react to market signals and changing tastes. This makes the small enterprise more innovative and open to new ideas. Opportunities exist for small-scale sector to emerge a strong global player especially in the exports of the following products.

a. **Food Processing Industry:** India has been the second largest producer of a very wide variety of fruits and vegetables in the world. But, it processes less than one per cent of production. This figure of India is far behind the figures of 30 per cent of Philippines and 83 per cent of Malaysia. The major reasons for country's low

share in the international market have been over-dependence on a few recognized international markets, lack of quality control, poor packaging, high cost of production, inadequacy of infrastructure like transport and power and non-availability of required inputs at right time and price.

b. **Leather Goods:** India has the largest cattle population and, thus, has a substantial raw material base for leather-based industries. At present, the country's share in the world leather market in about 4 per cent and the target is to raise it by 10 per cent by 2000 because this sector holds potential for exports. However, this sector is plagued by certain weaknesses too. These are low volume of production units, poor quality, lack of standardization, poor delivery and absence of technological upgradation.

c. **Electronic Goods:** The electronic industry has registered a phenomenal compound growth rate of 35 per cent during the last decade 1981-90. The share of small sector, in 1993-94, was 40% of output and 30% of exports of electronic industry. Though the small scale industrial units have been exporting items from ordinary to hi-tech products, yet its share in the global market is very low just 0.15 per cent and that too 80% exports are from Export Processing Zones alone. The electronic industry holds tremendous potential for exports in electronics, software and contract manufacturing. This potential needs to be tapped.

d. **Plastic Goods:** The plastic industry has made an impressive growth in recent years. At present, out of 18,500 units manufacturing various industrial and consumer plastics, around 18,000 units are in small sector. The items of plastic exports include carrier bags, garbage bags, shopping bags, woven sacks, plastic molded household items like insulated thermoware, pens, spectacle frames, PVC hoses, PVC leather clothes, etc. In 1992-93, the small sector accounted for 45 per cent of these exports.

14.6 SUGGESTIONS TO IMPROVE EXPORTS

The Government of India has accorded high priority to the

development of small-scale industries in the country. Under the protective and promotional policies of the Government, the small scale enterprises have made their presence felt nationally and internationally. The share of small scale enterprises in the country's exports has risen from 11 per cent in 1970-71 to 35 pr cent in 1993-94. Realizing the good export potential of small sector, the Board of Trade and Ministry of Commerce have identified 8 sectors and 15 items respectively for boosting exports from the small-scale sector. However, the bug bear of the sector has been the inadequacies of capital, technology and marketing. If the export potential of small scale enterprises is to be tapped to the full extent, then the issues like simplification of procedures, easier access to the bank and institutional credit, improvement in infrastructure and marketing issues need to be attended to expeditiously and adequately. Then, it would not be difficult for the small scale enterprises to help the country achieve a target of at least 1.5 per cent share in the world export in the nest 10-15 years.



ACTIVITY

"Exports from small sector have fallen prey to some bug bears." Justify the statement.

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CHECK YOUR PROGRESS

Q2: State true/ false :

a. ... Technology is the crux of quality and ..... competitiveness. (T/F)

b. The electronic industry has registered a phenomenal compound growth rate of 35 per cent during the last decade 1981-90. (T/F)

Q3: Fill in the blanks

a. India has been the ……. largest producer of a very wide variety of fruits and vegetables in the world.

b. The full form of W.T.O. is …….

14.7 MEANING OF E-COMMERCE

It seems pertinent to mention at the outset that e-commerce is not about reinvesting business. It is about streamlining current business process to improve operating efficiencies which, in turn, will strengthen the value to provide to customers, which in turn will provide the competitive advantage over competitors. In simple words, electronic commerce is the process of doing business electronically or over internet.

In other words, e-commerce encompasses the use of technologies, processes and management practices that enhance organizational competitiveness through strategic use of electronic information. E-commerce is, thus, a modern methodology that addresses the need of organizations merchants, and consumers. It cuts costs while improving the quality of goods and services and increasing the speed of service delivery.

14.8 CONCEPT OF EVOLUTION AND GROWTH

The evolution of e-commerce is traced back to 1970's with the mergence of internet. E-commerce was developed for the business community in the early 1970s to facilitate processing high volume and high value transactions electronically. Electronic Data Interchange (EDI) was the first business-to-business (B2B) application. Subsequently, internet added a prodigious new dimension to e-commerce. The power of the Internet, as a global access, was realized with the arrival of the World Wide Web (WWW) in 1994. Further, e-commerce in US is taking place more in the service oriented activities than the product oriented ones. This is because of the fact that no two products are the same. But, services have a commonality that makes maxim for more general applicable whether it is hospitality or airlines, transport services, banking, reading of books and alike.

The origin of e-commerce in India coincides with the introduction of Internet connectivity in the country in 1989. As such, e-commerce in India is in its infancy. Historically, Rediff-on-the-net, one of India's leading online services, set up India's first e-commerce on August 13, 1998. Then, India entered the age of e-commerce the day the government

deregulated the Internet Service Provider (ISP) policy in November 1998. Since then, there is no looking back and the country is proliferating in Internet. The rate of growth of penetration of Internet has been spectacular. It took radio 50 years to have 50 million owners, T.V. 16 years and personal computer 17 years. But it has taken internal only 4 years to reach that figure after the invention of WWW and browsers.

NASSCOM (National Association of Software and Service Companies), the apex body and Chamber of Commerce of India's software-driven IT industry, has recently released findings of its survey to evaluate the E-commerce scenario in India.

This is attributed to the fact that in B2B transactions, both buyers and sellers are known to each other and enjoy sufficient mutual trust. Added to it is that B2B transactions are relatively of higher value in nature and companies trading on Internet offer very high and attractive cost saving options.

Another point worth mentioning is that the expansion of e-commerce in India, so far, has been uneven concentrating in a few metropolitan cities, namely, Bangalore, Hyderabad, Mumbai and Delhi. The common man residing in rural areas of the country is, however, still unaware of happening in Information Technology sector.

In nutshell, e-commerce has set in but much is yet to be tapped in this respect.

14.9 BENEFITS OF E-COMMERCE

E-commerce is a win-win situation for the consumer and the product/ service provider. The distinct advantages e-commerce can offer to the consumer are:

1. Consumers have a much wider choice available on the cyber market.
2. They can compare products, features, prices and even look up reviews before thy select what they want.
3. They also have the convenience of having their orders delivered right to the doorstep.

4. Finally, consumers are driven to e-shopping in hordes as even branded goods cost less on the Net.

The major advantages that e-commerce can bring to the companies are:

1. **It minimizes inventory cost:** E-commerce venture need not maintain huge inventories or expensive retail showrooms. Their marketing and sale force is a fraction of that of traditional mortar-based businesses. E-commerce can minimize inventory costs by adopting just-in-time system enhancing the firm's ability to forecast demand more accurately.
2. **It can improve customer services:** It has been found that providing both customer and after-sale services account for up to 10 per cent of the operating costs. By putting these services on-line under e-commerce, these costs get reduced, on the one hand, and simultaneously the quality of services also gets improved, on the other. High quality customer relationship called "customization" is crucial for retaining customers in the e-commerce environment. E-commerce provides ample opportunity for CRM solution and, therefore, is establishing better relationship with the customers. It becomes absolutely necessary for the company to enhance customer loyalty, otherwise the customer who is full of choices, can jump from one website to another.
3. **It reduces distribution costs as well:** The Electronic Data Interchange (EDI) based on OECD study has revealed that the time needed to process an order declined abruptly by a minimum of 50 per cent to a maximum of 96 per cent.
4. **It helps business globalize:** E-commerce by minimizing costs enables companies' especially small ones to make information on its products and services available to all the potential customers spread over worldwide.
5. **It helps market products more quickly:** By taking the entire product design process on-line, drawing partners and customers into the process and removing the traditional communication barriers, companies can bring products and services to market far more quickly. Internet commerce solutions allow customer to reduce

the costs of sales and open new markets, speed and simplify order accuracy, approval, processing, tracking and delivery and improve decision making, leverage existing investments in infrastructure, business systems and repositions and link manufacturers with suppliers on the same network.



CHECK YOUR PROGRESS

Q4: Fill in the blanks:

a. .. EDI stands for ……

b. Electronic Data Interchange was the first ……..application.

c. E-commerce provides opportunity for …… solution

Q5: What are the benefits of e-commerce?

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14.10 SUITABILITY OF E-COMMERCE FOR SMALL UNITS

Because of the significance of small enterprises worldwide, it is increasingly being realized that if small sector gets left behind in the information, then the whole economy gets left behind. Given the need of the hour, small enterprises, therefore, cannot have the luxury to adopt a wait and watch attitude in the matter of marketing. Late adoption of e-commerce will adversely affect the small enterprises for years to come.

With strong realization, small enterprises worldwide are turning in the use of modern technology to compete with big brothers – medium and large size enterprises. According to a survey conducted by the Yankalovick Partners Inc., 90 per cent of the small enterprises in US are using wired technology in their operations. Numerous e-commerce success stories abound in other countries as well.

The information revolution ahs opened up a great deal of potential

for small enterprises in the marketing field. The excellent opportunities e-commerce offers to small enterprises are to:

- Access new markets
- Improve customization
- Lower various kinds of costs
- Reduce the size of the enterprise
- Sell products/ goods into global market.

It is e-commerce that facilitates, for example, a tailor is Sweden to make a suit by hand for a lawyer in London, Similarly, a software designer in Bangalore to write a programme to a firm located in Moscow. The fact remains that e-commerce has empowered small enterprises like nothing else had done so in the past. E-commerce has emerged as an opportunity for small enterprises. Not making use of it will turn into a threat to their very survival. The adoption of e-commerce in small enterprises has reached to global presence and is offering stiff competition to their big brothers. It is noticed that web-based big companies eventually have forced numerous small companies to go online for their business operations.

14.11 PROSPECTIVE AREAS FOR E-COMMERCE

E-commerce is ideally found suitable for certain types of products and services amenable to online transactions. The products that are already being traded electronically mainly in small enterprises and are also expected to record high growth rate included computer products, books, music, gifts and flowers, clothing and food items. Similarly, the services which are likely to be quite fertile for e-commerce, are advertising and marketing services, financial services, tourism, entertainment and information services. Experts opine that the top three services, travel and entertainment/ sports services.

In India, small sector is an all embracing term. Small enterprises in India include agriculture and agro-based industries, transportation, financial services, housing, handicrafts, readymade garments, footwear, professional services, electronic and engineering, chemicals,

pharmaceuticals, gems and jewelery, cosmetics, furniture, poultry, bakery, retail trade, entertainment, health care, tourism, education, social services, public utilities etc. Due to dismal penetration of PCs and telephones into rural economy, the vast potential for e-commerce offered by rural areas so far remains untapped. There is no denying the fact that rural sector is the main stay of the Indian economy that supports nearly three-fourths of the country's population. Hence, there is a need for e-commerce mandarins to make inroads in rural areas of the country.

It is worth mentioning that efforts are on to bring small enterprises and rural areas within the folds of e-commerce. For example, a new website, namely, Indianmarkets.com is created with the objective to provide small enterprises direct access to the corporate sector as well as national market. Expectedly, this gateway will provide a seamless system for interaction between buyers and suppliers by providing them single contact point online. Following this, Satyam Computers Services have also created an ASP to facilitate small enterprises with advanced e-commerce applications/ solutions. With this objective in view, the Ministry of small scale industries has formulated a comprehensive plan to prepare small-scale industry (SSIs) for e-commerce with required infrastructure support in the country.

14.12 CHALLENGES FACED BY E-COMMERCE

E-commerce in spite of opportunities, hoopla and hype, also bears the connotations of challenges as well at the same time. We, therefore, enumerate the major challenges e-commerce in small enterprises is facing and also submit the remedial measures to met these challenges.

1. **Infrastructural Problems:** Internet is the backbone of e-commerce. Unfortunately, Internet penetration in India is so far dismally low at 0.5 per cent of the population against 50 per cent in Singapore. It is difficult for e-commerce to reach to 1,000 million population spread over 35 million households in 6,04,374 odd villages and 5,000 towns and cities. Besides, both cost of PCs and internet access in India are quite high.
2. **Absence of Cyber Laws:** Another big challenge associated with

e-commerce market is the near absence of cyber laws to regulate transactions on the Net. WTO is expected to enact cyber laws soon.

3. **Privacy and Security Concern:** As of to-day, quite vulnerable issues related to e-commerce are privacy and security. So far, there is no protection offered either by Website or outside watchdogs against hazard created by exploiting one's privacy.

4. **Payment and Tax Related Issues:** Problems related to payment and tax are yet another problems continuously hunting e- traders. The electronic payment is made through credit card or plastic money which could, however, not become popular so far in India mainly due to two reasons. First, the penetration of credit card in India is very low (2 per cent of the population). Second, the Indian customers are quite skeptical of paying by credit card with the increasing threat of fraud played by hackers. Credit card could not gain growth in India mainly because of authentification and recognition problems of electronic signatures.

5. **Digital Illiteracy and Consumer Psyche:** At present, digital illiteracy is one of the formidable problems e-commerce is facing in India. On the other hand, the continuous exodus of skilled computer engineers to other countries has denuded India of software engineers. This has posed a real threat to the Indian IT industry. Obviously, solution to this problem lies in curbing the computer brain-drain and uses the same in the country.

6. **Virus Problem:** That computer virus is also a formidable problem in the execution of e-transactions is confirmed by the recent computer virus originated in Manila. The offenders causing 'virus' must be awarded deterrent punishment, otherwise similar assaults in future can cause lasting blows to the quite young e-commerce in India as well.

7. **English Specific:** Last but not the least, the software so far in the country is English specific. But, in order to make e-commerce reach to the small enterprises, it needs to be available in the languages (regional) of the owners of the small enterprises to

enable them to adapt e-commerce processes in their operations.



ACTIVITY

"E-commerce is a win-win situation for the consumer and the product/ service provider". Explain.

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CHECK YOUR PROGRESS

Q6: State true/ false.

a. ... E-commerce is the process of doing business electronically or over internet. (True/ False)

b. The origin of e-commerce in India coincides with the introduction of Internet connectivity in the country in 1988. (True/False)

Q7: Fill in the blanks.

a. The full form of NASSCOM is ……..

b. Minimizing inventory cost is one of the advantages of ……

c. …… is the backbone of e-commerce. .....



14.13 LET US SUM UP

In this unit, we have discussed on the following concepts:

- At present, the share of small enterprise export accounts for about 35 per cent of the country's total export.
- Export from Small sector suffers from the bug bears of credit, infrastructure, technology, etc.
- In order to tap the export potential of small sector to the full extent, the issues like simplification of procedures, easier access to the

banks and institutional credit, improvement in infrastructure and marketing need to be attended to well in time.

- Electronic Commerce is doing business over Internet.
- In India its origin coincides with Internet connectivity in 1989.
- At present there are 3.2 million Internet users giving a total volume of Rs.131 crores e-business.
- Lack of infrastructural facilities, absence of cyber laws, payment and tax related matters, digital illiteracy and virus problems are the major challenges before e-commerce in India.



14.14 FURTHER READING

1. B. Bhatnagar and A Budhiraja(2011), *Entrepreneurship Development & Small Business Management,* Vayu Education Of India
2. Khanka SS (2007), *Entrepreneurial Development*; S Chand & Company; Reprint Edn. 2006 edition
3. Scarborough and Cornwell (2016), *Essentials of Enterpreneurship & Small Business Management,*Pearson Education India; Eighth edition
4. Charantimath(2013), *Entrepreneurship Development and Small Business Enterprises*,Pearson Education India; Second edition
5. Pathak R.K. and Kalwar M.C.(), Business Organisation and Entrepreneurship Development



14.15 ANSWERS TO CHECK YOUR PROGRESS

Ans to QNo. 1: The major constraints encountered by the small scale units

a. Technology b. Credit Policy

c. Infrastructure

Ans to QNo. 2:a. True b. True

Ans to QNo. 3:a. Second b. World Trade Organization.

Ans to QNo. 4: a. Electronic Data Interchange b. business-to-business c. CRM

Ans to QNo. 5:the benefits of e-commerce are as follows:

a. It helps market products more quickly
b. It can improve customer services
c. It reduces distribution costs as well
d. It helps business globalize
e. It minimizes inventory cost

Ans to QNo. 6:a. True b. True

Ans to QNo. 7: a. National Association of Software and Service Companies b. E-Commerce c. Internet.



14.16 MODEL QUESTIONS

1. Bring out the problems and potentials of exports from small-scale enterprises?
2. What measures will you suggest to promote exports from small-scale sector?
3. Discuss the major constraints encountered by the small scale units.
4. Define the term ‘e-commerce’. What are the advantages e-commerce can offer to the customer and the suppliers?
5. Explain with examples how e-commerce is suitable for small enterprises.
6. List prospective areas for e-business in small sector.

UNIT 15: CASE STUDY

Entrepreneurship is more than the mere creation of business. The characteristics of seeking opportunities, taking risks beyond security, and having the tenacity to push an idea through to reality combine into a perspective that permeates entrepreneurs. In this Unit, we will discuss about few such entrepreneurs who have created their own path.

Case 1

Dr. Nomal Chandra Borah and GNRC

Dr. Nomal Bora is a neurologist and the founder of the first super-specialty tertiarycare hospital in the North-East India popularly known as Guwahati Neurological Research Centre Limited (GNRC) in Assam, India. He is also the Managing Trustee of Asian Institute of Nursing Education and also the owner of Medishop retail chain. Dr Borah set up GNRC in 1984 with the help of Dr. K V Mathai, well-known neurosurgeon from Vellore. Eventually, in 1985, GNRC was turned into a Limited Company.

Born in a peasant family at Dubia (Gohpur), Assam in 1950, Dr. NC Borahhad a humble beginning in life. Both his parents could not read and write but he was never denied education. His early education began in the village primary school. Besides his studies, he used to help his parents in the field. Dr. Borah's father was not financially sound but it never discouraged him to go for higher education and he did private tuitions to meet the expenses. Dr. Borah passed his Higher Secondary Examination with excellent result and got admission into the MBBS course at Guwahati Medical College on merit list. An educational loan from Government of Assam and a state merit scholarship assisted him to complete his degree. After that he joined the Medical College as a demonstrator in Pathology and completed his Diploma in Clinical Pathology. Later on after completing his MD degree in Internal Medicine, Dr. Borah joined AIIMS in a three year programme in Neurology leading to DM degree. In 1992 he did a Graduate Summer Course in Epidemiology and Biostatistics from the University of Michigan, USA.

He has a number of awards and achievements; such as the Fellow of the

American Academy of Neurology (FAAN) for his contribution to neurological services in (2003);East Chamber of Commerce and Industry for Service to Society through Individual Excellence, (2005); Honorary Fellowship for significant contribution towards the development of Neurosciences in Eastern India from the Association of Neurosciences of Eastern India, 2012 etc.

When the GNRC was established in 1984, the number of private enterprises in the health sector was grossly insignificant and inadequate. The challenge for starting an enterprise was daunting. Dr. Borah did not have monetary and infrastructural resources also. He had to mobilize the resources. With tremendous willpower, he treaded his entrepreneurial path with a strategic plan. After the initial success with the neurological services, the hospital made an entry into the heart care area. Gradually, the hospital developed its facilities to offer services in other specialties. Moreover, the hospital expanded its facilities to other areas like Amingaon, Sixmile in Guwahati. In order to capitalize on emerging opportunities in organized retailed and retailing of pharmaceutical products, Dr. Borah took a big risk of venturing into the retail sector. GNRC Medishop is one of the first Online Pharmacy in Guwahati, It caters to Online Medicines in India and also to entire Northeast India. Get free Home Delivery of Online Medicines at your doorstep.Though he did not have any background in retailing, the venture yielded the results. In the process, he learnt many hard lessons in managing the business of a retail chain.

Today, GNRC is an established brand in the North East India. It has been able to create employment avenues and entrepreneurial opportunities for many. All these have been possible because Dr. Borah once decided to be an entrepreneur and stayed determined and focused in his mission. The obstacles in the process did not deter him in reaching his entrepreneurial goals. He has earned respect and regards from the society. He has won a number of awards and honors from different organizations in the society.

Question : Was it a right decision for an entrepreneur in the health sector to start an enterprise in the retail sector?

Source: https://en.wikipedia.org/wiki/Nomal_Chandra_Borah

Case 2

Case Study on Nykaa : E-Commerce Platform for Beauty and Cosmetics Products

Nykaa is an e-commerce platform for beauty and cosmetics products. Nykaa was launched in 2012 by FalguniNayar.The platform offers a wide range of categories including skincare, makeup, luxury products, fragrances and hair care products for both men and women.

Falguni Nayar is the Founder and CEO of Nykaa. Nayar was born and raised in Mumbai. Falguni is a graduate of the Indian Institute of Management, Ahmedabad. She worked for Kotak Mahindra Capital Co. for 18 years.When she left in 2012, she was the managing director and head of its institutional equities business but she wanted to be an entrepreneur, so she started this new business of online beauty products.

How Nykaa Started:

After leaving her job, Falguniwas looking for business opportunity in India and she noticed a huge gap in the beauty products markets in India. She noticed that the demand was on the top but there were very few places to get the genuine beauty products. As the online market is booming in India with more and more internet users, she has taken this opportunity to grab the online beauty products market.

Nykaa Business Model:

The company has an Inventory-based model that has helped the brand to gain its name in the fashion and cosmetics industry. The products are 100 percent genuine and authentic, sourced directly from the brands. Nykaa provides a hassle-free shopping experience, the virtual makeover tool, beauty advice and assistance on the phone, free expert advice and articles on beauty trends and tutorials and celebrity looks.

Nykaa sells more than 35,000 products from 650 brands, both international and Indian, luxury and mass, and is constantly adding new labels to its stock. In 2015, Nykaa introduced her own brand and it has gone on to become a best-seller on the platform.

Nykaa Revenue:

Nykaa's revenue has grown close to 300% in the last two years. In 2016, it raised a total of 104 crore rupees from investors and the company hopes to break even by the end of 2018. The company is also eyeing for an initial public offering in 2020.Nykaa is receiving 15,000 orders a day, mostly from consumers between the ages of 22 and 35.

Nykaa Marketing Strategies:

Nykaa depends on content marketing for their marketing strategy. They provide high-quality content to showcase the global trends that have proved a winning formula for the brand name.The high-quality content generates traffic on the website. Nykaa uses email marketing and social media marketing for remarketing. Nyka also collaborated with Femina to host the 'Nykaa.com Femina Beauty Awards' in 2015 and 2016 to create the brand awareness.

The experience of being an entrepreneur was a childhood dream for FalguniNayar. The opportunity to build Nykaa.com, a woman centered business, with a multi-brand retail format in the beauty and wellness space is a big accomplishment. The fact that she was doing it with her daughter Adwaita made it both exciting and meaningful. During the course of her journey, she sought advice from many people.

Question : What could be the challenges for Nykaa in sustaining its business?

i. *Source:https://www.whizsky.com/2017/09/case-study-nykaa-e-commerce-platform-beauty-cosmetics-products/*

ii. *https://hbr.org/product/nykaa-com-a-passion-for-beauty/218049-PDF-ENG*

iii. *Nykaa.com: A Passion for Beauty**case study** by Paul A. Gompers, Anjali Raina, RachnaChawla*

Case 3

Women spirit wins: A case study of Lijjat Papad:

Shri Mahila Griha Udyog Lijjat Papad Society is an enterprise with an aim to

facilitate women entrepreneurship and empowerment. In the process, it endeavors to createand promote a feeling of sisterhood and carefulness.

In our society women assumes an important and respectable part. To be independent theyhave started showing interest in their own business. They are coming with product and innovatory ideasand starting the small and medium enterprises. With their hard work and with sheer dedication they arechanging the conception of society. Toenhance their self-respect and status, women require social support to battle their sense of inefficiencyand fear. One of the remarkable examples of women entrepreneurship is the "Lijjat Papad Society".

The foundation of Lijjat Papad Company is the devotion of 7semi-literate women in 1959 from Gujarat which made it aprofitable company and a brand known in foreign countries as well. These womenstarted out on the roof of a large, old and a residentialbuilding called LohanaNiwas in Girgaum, which is amassively populated area in South Mumbai. They wanted tocreate a livable source of employment by using the only skillthey experienced i.e. cooking. Changalal Karamsi Parekhwas the person who gave them credit of Rs.80 forcommencing their work of papad making. He became theirguide. He advised them never to compromise with the quality ofpapads and urged them to make quality papads. In the first year,because of the rainy season they had faced many problems indrying papads. But the problem was solved by the next rainyseason by buying a cot and a stove which helped them in theprocess of drying papads. The number of women increasedslowly and the earnings of the company increased day byday. Presently this company provides employment to 43,000women and profits and losses are produced by these entire43,000 sister members. In Assam, we have many Self Help Groups, but none of them come up so big.

Question : Can a success story of Lizzat Papad be replicated in North East India?

Case 4:

Innovations in Agriculture and Udhab Bharali

Advances in technology are key to the future of agriculture as farmers strive to feed the world with limited natural resources and combat climate change.

It was with this in mind that ace innovator UddhabBharali began inventing; and came up with over 140 gadgets whose simplicity of design and mechanism could mark their usefulness in agricultural work.

Based in Lakhimpur on the northern bank of the Brahmaputra in Assam, Bharali says his vision is "to change the agriculture scenario and boost the economy while being environmentally responsible". From tasks like pomegranate deseeding and peeling cassava to bigger ones like paddy seeding and processing tea, Bharali has designed machines for a range of uses.UddhabBharali, the serial innovator, is a man who's energy-efficient and low-cost machines have been instrumental in simplifying several agricultural processes for many.

Born in a middle-class business family, Bharali completed his schooling from Lakhimpur and took admission in Jorhat Engineering College. However, he had to drop out of engineering college because he could not afford to pay the fees and had to care for his family. In order to pay his father's debts and to cater to his natural flair of developing new machines, he developed a new polythene-making machine to cater to the demand from surrounding tea estates in Assam.The success of this machine gave Bharali the confidence to develop more machines.

As the only earning member, he knew that it was up to him to take care of his family's needs. He resolved not only to earn enough to sustain his family, but also to help the lives of others living below the poverty line. With this vision in mind, he concentrated on making products to serve rural public and commercial purposes.

His early days of creating machines to simplify laborious tasks like peeling garlic or cassava were challenging, he says, recalling how he was constantly mocked for not doing something 'worthwhile'. But he was undeterred. From 1990 to 2005, he invented 24 machines.

In 2005, Bharali's talent came to the attention of the National Innovation Foundation, Ahmedabad and they took him aboard as a grassroots innovator. In 2006, his design for a pomegranate de-seeding machine was recognised as the first of its kind not only in India, but across the world.

This machine could separate the outer hard skin from the inner thin

membrane without any damage to the seed, easily de-seeding around 55 kg of pomegranates per hour. Orders started pouring in, including for export to Turkey and the US after that, and he finally made his mark as an innovator. And since then, there has been no looking back for him.

Bharali also developed an areca nut peeling device that could peel around 120 nuts in a single minute. With the aid of National Innovation Foundation, he invented (for different operations such as cassava peeling, splitting long lengths of bamboo, sizing, surface finishing etc) many low cost machinery. Reducing hours of back-breaking labour, his simple innovations were a great help to the large number of local people for whom agriculture was the sole source of livelihood.

Among his popular innovations is the mini tea plant for green tea and Crush Tear Curl (CTC) tea, aimed at helping the growing population of small tea growers of Assam.

Bharali's cement brick-making machine is another marvel that can be operated by anyone—including people with disabilities. The Central Silk board sought his guidance to redesign a sophisticated reeling machine. He also designed a stevia pulveriser& passion fruit gel extractor for North Eastern Region Community Resource Management Project (NERCRMP). He has also invented a paddy seeding machine that doubles the rice yield while making the entire process easier and less time consuming. Resembling a cart, the machine, priced at a modest Rs.3,000, will also yield better quality rice because the seeds are encased in plant protection and germinating material. Supported by the Assam Agricultural University, the 'Uddhab' machine is nowready to be introduced to the farmers' community.

He has opened the UKD Trust through which he gives a monthly pension of Rs 1,200 each per month to six widows, while three physically challenged persons get Rs 2,500 each per month. He also runs a small research and training institute where he educates and train underprivileged students for three months on technology and its applications. He is in the process of setting up an orphanage, an old age home and a museum at his humble abode for students to take a look at all his innovations and understand how

they work.

Question: Discuss the role of innovation in enterprise development.

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