

# Human Resource Management



12

## CHAPTER OBJECTIVES

- To become familiar with the process of hiring an employee
- To describe the interview and induction processes
- To understand the ways of motivating employees and providing training to them
- To highlight the important aspects of salary and perks
- To know the process of terminating an employee's services

## INTRODUCTION

In today's knowledge-driven economy, an employee has a vital role in producing the end product. Getting quality employees is one of the biggest challenges facing entrepreneurs today. There is a global shortage of trained manpower and the first to be hit are going to be small firms. Employees would much rather have the security and esteem that comes with a job in a well-known large company.

Cynics may point out that a company gets the kind of employees it deserves. That may be right, but it is not correct to assume that entrepreneurial ventures do not deserve to get the kind of employees they require.

The key to retain good employees is to create job conditions that they desire and then getting the productivity the entrepreneur wants. An entrepreneurial firm should give deep thought to the processes supporting the hiring, managing, and even firing of employees.

## HUNTING FOR SUITABLE CANDIDATES

Like everything else, finding a worthwhile employee is difficult, and it needs considerable effort. It is very important to match the skills of the person to the requirements of the job. Many times, this basic rule of hiring is forgotten.

The first step in hiring is to find whom you need to hire. When you have a business plan in place, it will give you a very good idea of the tasks that have to be completed to set up operations and run the business. From the list of tasks, it will be easy to deduce the number of people you will need and the skill level and experience of the employees to be hired.

Hiring will not be a one-time activity. Even the initial hiring will be staggered over a period of time because you will need different types of employees to be on board at different points of time. Also, after the initial hiring is done, you will continually need to hire to fuel the growth of the firm or to replace employees who have left the job.

Hiring starts with defining the position with a comprehensive job description. It is good to include all details such as given here:

- Details of the job responsibilities
- The qualifications desired
- The kind of experience the candidate should possess
- Salaries and other benefits to be given
- Career path

All of the above details need not be included in the initial communication to the candidates. Usually, the salary and career path are withheld to be discussed during the job interview.

The two ways of hiring most preferred by entrepreneurs are through acquaintances and through recommendations. Though these ways may seem to be ad hoc, they are very effective in the hunt for good employees.

### **Through Acquaintances**

People you know personally can be good employees. Technical skills are important but the more important traits are willingness to learn, passion for the work, and honesty. There is no reliable way to correctly assess these characteristics in a short interview. So, it might be better to resort to some you know personally or professionally.

The best candidates may not be looking for a job. They may even be working for your customer or competitor. Hiring from a customer can result in losing the customer, but you are in a position to judge whether it is worth taking the risk.

### **Through Recommendations**

A recommendation/referral is the next best thing to know the candidate personally. It can be from an existing employee, a business associate, or a friend. A good word from a person whose opinion you respect is enough reason to pursue a candidate. It is always good to know why that person holds the candidate in high esteem. Your reason for hiring may not match that person's perceptions of whom you want to

hire. Many firms in the technology sector have an employee-referral compensation programme. There is no reason why it should not be extended to other sectors as well.

If it is not possible to come across a desirable candidate by the above methods, it is time to spread the word through forums and professionals meant for this purpose. Information about jobs available can be disseminated in various ways as discussed here.

### ***Advertisements in Local Newspapers***

Usually, a newspaper has a special day for all job-related postings. It will be cheaper to post an ad on that day than in a normal slot. Jobs available may also be advertised in the classified sections. This works out very cheap, but it may not be productive when searching for high-level skilled employees.

### ***Using Job Portals***

There are a number of very successful job websites such as naukri.com, timesjobs.com, monster.com, and others. It is easy to get jobs listed on these sites. For example, a single listing in the classified section of naukri.com costs ₹ 845 and the costs can be much higher for premium listings. A very high visibility slot can cost a few lakh bucks per year.

An interesting option can be not to post a job offering but to get access to all the resumes listed in a job portal. This will allow you to choose from a host of candidates who have submitted their resumes. This too does not come cheap with a year's access costing about ₹ 22,000. The downside of this alternative is that many would have found the job they were looking for and some might have reservations about joining a start-up.

### ***Contacting a Placement Agency***

Tapping a placement agency is a good way to get employees. There are quite a few placement agencies in larger cities and they are a good way to reach active jobseekers. They charge the equivalent of one or two month's salary, and some may charge higher for some categories of jobs. It is wise to impose a condition to pay only if the employee stays with the organization for more than six months. In case the agency has a problem with that condition, at least a portion of the total payment can be withheld till the employee completes six months. Otherwise, the agency should agree to find replacement candidates if the selected candidate leaves early.

## **Exhibit 12.1 Online Work Exchanges**

Sometimes, the entrepreneur may need the specialized services of a professional and may not be able to find one locally. Now, there are many websites that allow employers to connect to freelancing professionals. These online exchanges are particularly focused

towards IT professionals, but one can find a variety of other professionals specializing in diverse fields such as graphic arts, creative writing, sculpting, editing, translation services, marketing, and legal assistance.

A prospective employer may post details of a project and registered professionals will then bid on the project. Most sites have a rating mechanism to help employers select the professionals. There is also a sophisticated escrow mechanism to reduce the risk of payment default or of non-completion of project.

Some of the prominent online exchanges for freelance professionals are given here:

[www.guru.com](http://www.guru.com)

[www.sourceforge.net](http://www.sourceforge.net)

[www.scriptlance.com](http://www.scriptlance.com)

[www.rentacoder.com](http://www.rentacoder.com)

## CONDUCTING INTERVIEWS

The interview is the first interaction of the candidates with the company. The company should put its best foot forward so that even unsuccessful candidates will have good things to say about the company. The entrepreneur and the employees already on board should appear to be professional and confident in all their activities.

Candidates are to be selected for interview based on their CVs submitted. Candidates should be invited for interviews by a written letter on the company letterhead specifying location, time, and supporting documents to be brought.

The interview can take place in your own office or a space can be hired in a hotel. Employing a placement agency gives the added advantage of being able to use their office for conducting interviews. If it is early in the life of the venture when your office is not yet ready, this can be an added bonus. Having the interview conducted in your own office place also serves to educate the candidates about their future workplace. While going to the interview, the candidate will have an idea of the kind of organization he/she is going to work for.

At the interview location, there should be a waiting room and someone to get them seated and to direct them as necessary. Often a standard CV does not give all the information you desire; in such case, it may be useful to have a formatted sheet designed to capture the particular information desired. For example, for employing a driver, you wish to know the make and model of vehicles driven.

There are many companies who use psychometric tests and group discussions, but the results they yield are not entirely reliable and may unnecessarily bias your selection. For testing technical skills, practical tests can be designed or a written examination can be resorted to.

The interview itself should be long enough to satisfy you that the candidate is suitable or unsuitable for the company and the job. It is helpful to have an interview panel, which

includes some senior employees or may be even others from outside the firm. The interview should aim to bring out the strengths and weaknesses of the candidate vis-à-vis the job requirements. This is also a good opportunity to inform the candidate about the job and what is required of him/her. The interviewer should invest some effort in painting a good picture of the venture by mentioning the good reputation of the entrepreneur, the growth prospects of the company, and the exciting challenges ahead.

The latter half of a fruitful interview should concentrate on negotiating a satisfactory pay and benefits package. You should be careful to avoid employees who choose to come on only for a higher pay packet. Employees 'bought' by a higher salary will be mercenary and will leave soon when offered an even more attractive package by some other organization.

On being selected, an appointment letter should be issued on a company letter-head. The appointment letter should mention date of joining, designation, and salary. Some important service conditions should also be mentioned.

## INDUCTION

An employee should not be put on the job immediately after joining. An induction programme helps to orient the employees and allows them to understand the company and their new job. In addition to learning their way around, information should be provided to enable them to contribute to the growth of the company very early. A good induction programme should have the following processes.

### ***Signing of Documents***

New employees are asked to go through the service rules and other related documents. During joining, they have to sign on a document that lists all service conditions and responsibilities of the employee and the employer. It is a good idea to get the new employee to sign a non-disclosure agreement (NDA) to protect proprietary information and intellectual property of the company.

### ***Narration about the Company***

A short talk should be given to introduce the new employee to the business of the company, their beliefs, and their long-term goals. The talk should include details of quality policy, current clients, and safety norms. Some larger companies use a full multi-media assisted presentation.

## **Exhibit 12.2**

### **Hiring Retired People**

A new entrepreneurial venture lacks experience and its employees too are likely to be relatively inexperienced. One very good way to tap into a pool of experienced people is

to consider hiring retired people. There will be many people who have had lot of experience working for big firms or government organizations and are now leading a retired life.

Especially, those who have worked in the government will have greater knowledge of the workings of government departments and will be able to get things done more efficiently.

While working with retirees, one should pay heed to the following aspects:

- They may not like to work on a full-time basis; so, you should be prepared to take them on as part-time employees.
- Due to their age, they might have special medical needs. The venture should be prepared to deal with that.
- They are also likely to take frequent holidays to visit children and grandchildren.
- They are senior people and they expect to be treated with respect by others in the organization, including their employer.

### **A Tour Around the Office**

A guided tour around the place of business will enable the new employees to feel the pulse of the place. Observing other employees at work will expose them to the standards and commitment expected of them. The areas of particular interest to the employees would be the canteen area, recreation room, and the workstations likely to be assigned to them.

### **Early Mentoring**

In the first few days on the job, a mentor should be assigned to help the new employee to adjust to the new job and also to ensure that the new recruit is capable of doing the job he/she has been hired for. Depending on the kind of job, this mentoring can take from a few hours to more than a few months.

Obviously, a detailed induction programme as discussed above would not be possible for the first few employees in a start-up. In that case, the induction plan has to be conducted personally by the entrepreneur, and the employees of this first have to be educated on their responsibilities to take care of the subsequent employees.

## **MOTIVATING EMPLOYEES**

Employees cannot be motivated simply by a salary hike or long-winded speeches followed by a warm handshake. Regardless of their level of employment, employees have the following expectations from their job:

- Recognition for good work done by them
- Meaningful participation in the venture's endeavours
- A feeling of belonging and of sharing in the success of the organization
- Opportunities for growth in accordance with their competence and experience

- Security in their job as long as they perform according to expectations
- Monetary reward for performance in their job
- Benefits relating to medical expenses and insurance

Salaries, perks, and other job-related benefits are the chief instruments used to keep employee motivated.

## Fixing a Salary

If a person is leaving a job to join your venture, he/she expects a salary higher than what he/she was getting at the earlier job. That may not be necessarily true. The employee may want to join for an entirely different reason. Some would be looking for an increase in responsibilities, some may believe in the future prospects of the venture, and some might want to shift because the job is convenient for some entirely different factors such as it may be closer to their home or the flexitime offered allows them to engage in other important activities. There are a few ways the employee is going to measure his/her salary:

- It is comparable to salaries of others in similar jobs in other companies within the industry.
- It should be comparable to what the employee is likely to get in some other job.
- It should be as good as the salaries of others with similar responsibilities within the company.
- It should be comparable to the salaries of his/her friends and peers outside the industry.

The salary cannot be expressed as a simple figure. It has a lot of components and is structured with tax regulations and other obligations kept in mind. The various components of a salary are discussed below.

1. The fixed component of the salary will include the basic pay and any dearness pay and dearness allowance added to it.
2. There will be a number of allowances including house rent allowance, house improvement allowance, vehicle allowance, and others.
3. Provident fund will be a statutory requirement for an organization with more than 20 people, and 8.33 per cent of the basic pay will be taken from the employee's salary and a matching contribution will be made by the employer. The employer can also institute some other pension or saving scheme for the employees.
4. Many employers find it beneficial to provide medical insurance and a life insurance cover too. Additionally, a medical reimbursement can be provided for incidental medical expenses.
5. Annual bonus can be based on salaries or on performance. Many employers have a standard practice of announcing the same bonus at the same time year

- after year. A variable bonus may be a better motivation. Also, the bonus can be declared at different times of the year such as Holi, Christmas, Diwali, etc. It can be nice to declare a surprise bonus on completing a big project or reaching a significant milestone.
6. In India, a bonus is traditionally less than 10 per cent of the total salary in a year, but in an entrepreneurial environment, it may be beneficial to design pay packages where the performance-based variable component is between 15 to 35 per cent of the total salary in a year.

### **Exhibit 12.3**

## **Employee Stock Option Plan (ESOP)**

An ESOP is an option to buy your company's share at a certain price. This price could either be the market price (price of the share currently listed on the stock exchange), or a preferential price that is usually lower than the current market price). If the firm's shares are not listed on any stock exchange, it could be at whatever price the management fixes it at.

Companies offer their employees ESOPs because it is considered that having an equity stake in the company would substantially increase loyalty and motivation. Depending upon the company's policies, an employee has to stay with a firm for a certain number of years before being eligible for ESOPs.

With regard to ESOPs, the employees are not taxed on acquiring the shares. The employees are taxed when they make a profit by selling the shares or transferring them.

7. Very few small entrepreneurial ventures have an employee stock option plan (ESOP). Some larger IT companies have them in place, but with the uncertainties surrounding share prices, they are no longer a very popular tool for benefiting employees. Usually, the companies issue stock options when they are about to go public. Overall, ESOP can be an effective way to compensate entrepreneurially minded employees.

Other entitlements relating to the job are also important to the employee. It is important to make sure that the employee feels that justifiable work-related expenses are being met by the company. The expenses the employees are allowed to incur in the course of their job are important in determining their attitude towards the employer and the job. The employee should be made to understand that the company is a start-up and needs money to grow, and a penny saved is a penny earned. Extravagances should be avoided, but the employee should be made to feel comfortable in the discharge of the duties.

The other important aspects to be kept in mind to keep employees' morale high are as follows:



1. In case of a desk job, the office environment should be clean, and all should have assigned spaces. In the case of most service environments, the office spaces are air-conditioned, and the décor is impressive. There is no need to splurge, but the looks expected of a professional outfit should be maintained.
2. Many factory spaces are also air-conditioned to encourage productivity. There should be service spaces such as canteens, rest rooms, and changing areas.
3. Sales persons expect to be compensated adequately for their travel and for frequent meals while on tour. They also expect the company to pay their communication costs, including cellphone bills.
4. While on outstation travel, the company should fix norms on maximum allowable spending on boarding and lodging and on other expenses relating to incidental travel, communication, etc. As long as these are well laid out and are communicated to the employees, there are few chances of unnecessary disputes.

### **Perks**

There are some non-monetary perks that can be effectively used to retain employees. Most are very easy to implement, and they do not cost much when compared to the value the employees are going to place on them.

### **Giving Awards**

Work-related awards and competitions have become commonplace. Companies institute 'employee of the month' award and other awards related to safety, quality, and productivity. If done right, this can be an effective motivator.

### **Recreational Activities**

Having a recreation room in the office is a good idea. It needs not be a fancy place with a pool table and a dance floor. It can be a simple comfortable place adjoining the canteen, having a few board games and a place to relax. Keeping it close to the work space will allow the employees to take their cellphone calls in this area without disturbing other working employees.

### **Annual Picnic**

An annual picnic is a good opportunity for employees and their families to get together. Food, fun and games with employees and their families is a good way to bond together. Taking this idea further and having an annual excursion will be a good idea. Nobile Ice Cream organizes an annual excursion during winter (the off season) and even distributors and their families are invited.

### ***Interaction with Employees' Families***

Apart from recognizing achievements of employees, praising and awarding their family members for succeeding in other spheres of life can enhance the self-esteem of the employees. For example, the daughter of an employee can be awarded in a small ceremony (may be during the annual picnic) for securing a position in her class at school.

### ***Conducting Seminars and Workshops***

Employees can be encouraged to attend seminars, workshops, and short-term courses. In larger start-ups, it may be possible to organize in-house seminars and workshops. Employees feel good about such self-development initiatives. The topics can range from yoga to acquisition of job-related hard skills.

### ***Providing Free Lunch***

Free lunch in the office is a good way to provide a mutually beneficial incentive. This also allows the employer to retain control over the length of the lunch break. Employees will not have to go home or elsewhere in search of a hot meal.

### ***Offering Discounts and Freebies***

Many apparel manufacturers give discounts to their employees who buy their products. This is also widely used in many other industries. It is very easy to implement in the service industry. Airlines and hotels will find it relatively inexpensive to give rooms and seats free to employees when occupancy is low. Baron Travels in Kolkata gives free overseas package holidays to its employees. It is easy to talk to other entrepreneurs and barter such employee benefits. For example, a restaurant can talk to a hair salon and each can extend a 30 per cent discount on a visit for each others employees.

Sometimes, some freebies are given to firms, and these find their way to the entrepreneur only. It is useful to distribute such benefits, whenever possible. Free passes to events, discounts, and promotional offers can be passed around.

### ***Participating in a Social Cause***

Involving employees in a joint social cause can serve to improve the morale and encourage a feel good factor. For example, employees of a publishing house in Mumbai have adopted a blind school, and they go regularly to read out to the students and to organize several events.

### ***Flexibility***

Employees can be allowed to work from home on selected days or for a few restricted days. It is good for keeping the spirit of the employees high, and productivity is not lost.

### **Providing Bonus**

Bonus can be given to some or all employees. Usually, differential bonuses are given out to employees. The differences are not based on performances but on current salaries. It might be a good idea to base the bonus on performance instead. The bonuses can be paid at the end of the fiscal year, but are more appreciated if given during Dusshera, Diwali, or such festive occasions.

### **Giving Gifts**

Gifts such as a watch or a household appliance on some important occasions or on reaching a milestone can bring joy to the employees.

### **Other Ways to Motivate Employees**

There are some other ways to keep the employee motivated that do not cost at all. These will require the employer to have a certain mindset to carry out these initiatives to boost employees' satisfaction.

### **Communicate with Employees**

Make the employees aware of what is happening in the company that may directly or indirectly affect them. They would appreciate it if informed when a new office is being opened or a new contract has been bagged, even if their work is not directly affected by it.

### **Solicit Suggestions**

A lot of good ideas can originate from employees. Often, they are closer to the customer than the entrepreneur. Suggestions can relate to internal changes in the workplace or about new products, service packages, etc. It can be done by using a suggestion box or having informal and formal brainstorming sessions. They can serve the dual purpose of getting solutions and elevating employees' morale.

### **Reinforce Contributions**

We have already discussed the importance of giving awards such as 'employee of the month,' etc. Even simple verbal recognition can serve to motivate employees. Annual performance appraisal is an effective way of letting the employees know how they have been helping the company reach its goals.

### **Work Environment**

Particularly in a new venture, it is essential to create a conducive work culture. The effort should be towards creating a work culture that employees find enjoyable.

That does not mean sacrificing productivity. The attempt should be to encourage employees to enjoy their work. One of the best examples worldwide is the design firm, Ideo. It is based in Palo Alto, California, and is one of the leading design firms in the world. The employees come from very diverse backgrounds such as MBAs from Harvard, bio-chem engineers, writers, and college professors. It is a very flat structure with very informal reporting relationships. Productivity gets rewarded, and there are no designations to speak of. People are encouraged to express their individuality. According to Tom Kelly, one of its founders and a Professor at Stanford, "people are encouraged to try out things and then ask for forgiveness rather than ask for permission before starting out."

### Exhibit 12.4 Great Places to Work

*Businessworld* has been carrying out a survey named 'Great Places to Work.' This survey is carried out in partnership with Grow Talent ([www.growtalent.com](http://www.growtalent.com)) and The Great Places to Work Institute of the US. The same methodology is used in India as well as 23 other countries, including the US and the UK.

The 2006 survey spanned over 100 companies, and over 16,000 employees were surveyed. Workplaces were ranked using qualitative and quantitative data based on the opinions of employees.

While most of the names figuring in the top ranks were large Indian companies or subsidiaries of MNCs, there were a number of smaller firms too. Classic Stripes, a Mumbai-based manufacturer of graphic accessories for cars and two wheelers, was ranked second in the survey. There were three entrepreneurial IT firms, Mindtree Consulting (now, a publicly held firm), Ajuba Solutions, and Tavant Technologies, which also featured in the top 25.

#### Great Places to Work 2006

Rank	Name of the company	Ownership
1	Risk Mgmt Solutions India	MNC
2	<b>Classic Stripes</b>	Entrepreneur
3	Google India	MNC
4	Federal Express	MNC
5	Marriott International	MNC
6	<b>Mindtree Consulting</b>	Publicly held
7	NTPC	Public sector enterprise
8	SAP Labs	MNC
9	American Express	MNC
10	Freescale Semiconductors India	MNC

Source: *Businessworld*

It is a very vibrant workplace, with quite a few visible quirks. There are cycles suspended from ceilings, and an airplane wing is part of the décor.

It will probably not be a good idea for people to adopt this model at every workplace, but each entrepreneur should think about implementing their own version of a unique work culture to encourage productivity and retain happy workers.

## TRAINING

Sometimes, an employee may be hired who does not possess all the skills and characteristics needed to discharge his/her responsibilities. It may be that he/she has been hired in spite of his/her shortcomings, keeping in mind his/her other good attributes or the current manpower shortage. It also may be that an employee needs to pick up new skills on moving into a job with higher responsibilities.

In all such cases discussed, it becomes essential to train employees. There are several ways to provide such training. Some are touched upon here.

### Training Institutes

There are a number of industrial training institutes. Many of these are run by the government and some are under private management. These would be good places to pick up technical skills such as welding, electric repairing, machine operation, etc.

Some coaching institutes provide classroom coaching for accounting, bookkeeping, basic computer skills, office administration, etc., which will also be useful to many start-ups.

### Business Schools

Many business schools have short-term training programmes, but these will be expensive and out of the reach of many entrepreneurial start-ups. There are some business schools that run programmes focused on SMEs. Many of these are partly subsidized by SIDBI or other organizations. For example, SIDBI subsidizes a three-month training programme for managers of SMEs, which costs participants about ₹ 6000 for the entire programme.

### In-house Training

This can be classroom-based, where an expert can be roped in to provide training to employees, or it can be on the job, when the expert trains the employees by doing it him/herself and then getting employees to do it under his/her guidance. This kind of training is most effective when it is about machine operation, etc. Many machine suppliers include training as a part of the installation exercise and include that in their cost.

## Online Training

Nowadays, there are many training programmes available on the Net. Many of these programmes employ a variety of media to deliver instructions and present facts. Interactive exercises are included, which make learning fun and easy. Online tutorials are extensively used to teach software programs and other IT-related topics.

### Exhibit 12.5 Why Does an Employee Leave?

Udayan Bose has a Master's Degree in Business Management and is an Engineer from IIT Delhi (1994). After working in MNCs for a few years, he decided to start his own venture and founded NetElixir. This business was aimed at helping online advertisers eliminate waste from their advertising campaigns and help them to be 'more profitable.'

His venture kept losing key members of the team very regularly. What hurt him most was that while leaving the venture, the employees would not be upfront and truthful about the reasons for quitting.

Udayan says, "A guy who was working with us stated that he was going to pursue a course in Java in Pune, another said that because of family issues she had to relocate to Bangalore, and the third said that he had received an un-putdownable offer as a testing engineer. All the three were lying."

He further states, "The interesting point is that they did not have to lie. When a team member leaves, understandably, I feel bad because we as a company invest a lot of time, energy, and resources on trying to get the person feel at ease with the environment and on getting him in control. There is an unwritten contract of association that is based on trust. The least that I expect from any team member is—he would be truthful."

## Maintaining Discipline

The first step to maintain proper discipline amongst the employees in the workplace is to establish clear and logical rules. These rules should be clearly communicated to the employees, and there should be a feeling of mutual trust between the employees and the entrepreneur.

The rules governing discipline within the organization should be fair, and it may be desirable to take the employees into confidence before enforcing them.

Besides the rules of conduct, the prescribed punitive action should be clearly specified and communicated to the employees. The rules and any punitive action thereof should be impartially imposed. There should be some flexibility to account for extenuating circumstances.

It is helpful to a firm to have a warning system in place. The first warning can be given to the employee in case of a first slip up. In case the errant behaviour is repeated, appropriate punitive measures can be taken.

## **TERMINATION OF EMPLOYMENT**

Some circumstances can make an entrepreneur to terminate the employment of an employee. This can be due to a variety of reasons. Some of the usual causes are highlighted here.

### ***Indiscipline***

The employee may be repeatedly engaging in acts of indiscipline, which serve to undermine the atmosphere of the workplace.

### ***Impropriety***

Impropriety can result when the employee misuses his/her authority to gain undue advantage compromising the business of the venture. These include the cases of stealing and selling goods, receiving kickbacks, and employing personally known people unfairly.

### ***Underperformance***

An entrepreneur had certain expectations of the employees, and if an employee is consistently unable to perform at the level expected of him/her, it might be best to let him/her go. An entrepreneurial firm can ill afford an underperformer.

### ***Lay-off***

Sometimes, a venture will have to lay-off people because it is not doing well. The problems are either with the entire industry or with that particular venture. Usually, the lay-offs are effected to improve the situation and to make the venture viable.

### ***Resignation***

Many employees leave when they find more desirable employment. Sometimes, the employees leave for a higher salary or because they find the experience of working in a start-up too demanding. Some employees leave because they have stopped believing that the organization can make it big.

## **Dealing with the Situation of Firing**

It is cheaper and more desirable to retain an old employee than to fire an employee and hire a new one. With that in mind, the initial effort should be focused on retaining the employee.

If the problem is indiscipline, the employee should be counselled by the entrepreneur and other senior employees. It might be easy to go to the roots of the errant behaviour and turn it around.

In case of underperformance, many times, the mistake may lie elsewhere. There may be a problem with the targets set or with the condition of the equipment assigned. It may be advisable to thoroughly investigate the real cause of the underperformance. Even if the employee is rightly identified as an underperformer, opportunities to improve his/her performance must be tried out before firing him/her.

Even though many entrepreneurs would like to give the employee the benefit of doubt in case of fuzzy evidence, all cases of impropriety should be severely dealt with. Cases of dishonesty are difficult to uncover, and those that have been unearthed should be handled strictly to serve as a warning.

When the entire industry is going through a bad time, the employees can be persuaded to take pay cuts and a drop in perks, so that no one is laid-off. When the software industry went through a bad time in the late 90s, some firms laid-off employees, while some others persuaded the employees to take pay cuts to minimize job losses. If the problem is with that particular venture, usually, lay-offs are inevitable.

An employee who is planning on leaving the organization can be persuaded to stay, but the employer has to be careful in how to persuade him/her. If the employee has been enticed back with a hike in salary, it will be a signal for other employees to try the same stunt. The employee should be won over by correctly portraying the future prospects of the company and how the employee stands to gain professionally in the long term by staying with the growing venture.

It is very important that the exit of the employee be very smooth. It will adversely affect the image of the venture if the employees say bad things about the entrepreneur and the venture. Also, given the employee protection laws of the country, it is very easy for the disgruntled employee to create trouble for his/her erstwhile employer. While firing an employee the following things should be carefully done:

- An exit interview should be conducted and reasons for the termination should be honestly discussed. It can also serve to educate the entrepreneur about problems to avoid in the future.
- A letter of recommendation should be promptly given to the leaving employee. As long as alternative employment is found by the employee quickly, the chances of any animosity are less. The letter of recommendation should not be unnecessarily flattering.
- All terminal benefits and other payments due should be made promptly. The employee should not be given the chance to claim that there are payments due from the venture.
- All documentation citing the reasons for termination should be organized. It would be helpful if the employee agrees with the reason of termination and signs a document stating so.



## Summary

Grabbing the attention of quality human resource is one of the biggest challenges facing entrepreneurs today. Hiring is not just a one-time activity, and even the initial stage of hiring takes a substantial amount of time. The process of hiring begins with defining the job opening with a comprehensive description of the job. It may be good to hire known people or those who are referred by someone known. Often, newspapers, websites, etc. have to be used to disseminate information about jobs available.

The interview is often the first meeting of the employee with the entrepreneur, and the entrepreneur should deal it professionally and competently with prospective candidates.

An induction programme helps to orient the employees and allows them to understand the company and their new job. A good induction programme includes signing of necessary documents, a tour around the workplace, and a detailed introduction to job responsibilities.

Salaries, perks, and other job-related benefits are the chief instruments used to maintain employee's motivation. The salary is not just a simple figure but has a number of elements. Other entitlements

relating to the job are also important to the employee. Most of the non-monetary perks, which can be effectively used to retain employees, are very easy to implement and do not cost much when compared to the value the employees are going to place on them.

Sometimes, an employee may not possess all the skills and characteristics needed to discharge his/her responsibilities. Also, employees need to pick up new skills on moving into a job with higher responsibilities. In all such cases, it becomes essential to train the employees. The training can be carried out in business schools, specialized training schools, or can even be done in-house.

It is essential to establish clear and logical rules to maintain proper discipline amongst the employees in the workplace. These rules should be clearly communicated to the employees.

The entrepreneur may have to terminate the employment of employees for various reasons. It should be carried out professionally, and all documentation should be completed immediately. An exit interview is of great importance during termination of an employment.

## Key Terms and Concepts

**Job description** An abstract of a job analysis used in hiring and placing prospective employees; contains the classification of and requirements for a job

**Interview** A formal meeting in person, arranged for the assessment of the qualifications of a job applicant

**Induction** A set of procedures signalling a formal entry into an organization, position, or office

**Referral** Recommending a person to someone or for something

**Mentoring** To serve as a trusted counsellor or teacher, especially in occupational settings

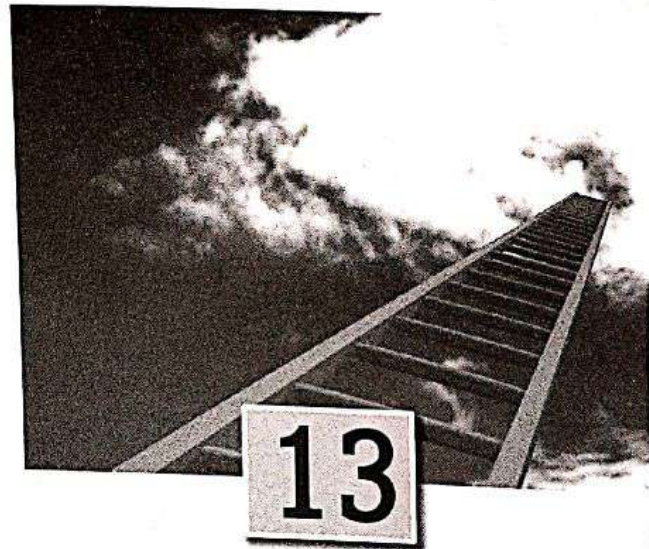
**Salary** A fixed monetary compensation periodically paid to a person for regular work or services

**Perk** An incidental payment, benefit, privilege, or advantage over and above regular income, salary, or wages; also known as perquisite

**Bonus** A sum of money given to an employee, in addition to regular pay; usually, in appreciation for work done, length of service, accumulated favours, etc.

**Exit interview** An interview with an employee whose employment has just been terminated

# Entrepreneurial Marketing



## CHAPTER OBJECTIVES

- To look at the marketing constraints of entrepreneurial firms
- To highlight the characteristics of entrepreneurial marketing and tabulate market research practices in entrepreneurial firms
- To discuss the concepts of segmentation, targeting, and positioning along with their relevance to entrepreneurial marketing
- To understand the process of brand building in entrepreneurial firms
- To explore pricing in entrepreneurial marketing and examine the distribution function in small firms
- To study non-traditional advertising in entrepreneurial firms and different types of promotional campaigns

## INTRODUCTION

Marketing is of critical importance to the success of entrepreneurial ventures. The marketing in a small, new venture is very different compared to the marketing practices in a larger firm. Marketing in a small firm is not just the scaled-down version of how it is done in a large firm. This difference is even wider in the case of entrepreneurial ventures as they are small as well as new. Very often, marketing mistakes are the reason a small, new firm might fail. There can be no marketing guide that can precisely prescribe the right marketing formula for a venture.

This chapter aims to bring together only those marketing concepts, methods, and tactics that are going to be of significance in the entrepreneurial context. Even though the principles of marketing remain same in an entrepreneurial venture, there are several other factors that assume importance.

## CHARACTERISTICS OF ENTREPRENEURIAL FIRMS

First, let us focus on the differences between entrepreneurial firms and larger, established firms. It is because of these differences that marketing in entrepreneurial firms needs a different approach compared to marketing in large firms.

### Limited Resources

Lack of resources is a problem faced by most entrepreneurial firms (Weinrauch *et al.* 1991). It prompts entrepreneurial ventures to seek to leverage their resources. Most ventures do it by the following ways:

- Stretching resources further than others have done in the past
- Exploiting the resources to the extent other firms have been unable to realize
- Using other's resources for one's own purposes
- Complementing one resource with another to create greater value
- Making use of some resources to obtain others

### Small Size

In addition to lack of adequate resources, smallness leads to low market share and lack of marketing power. It is difficult for entrepreneurial firms to achieve economies of scale. So, it makes even more sense to pursue mass customization and target niche customers by offering differentiated products.

The small size of the firm also prevents it from attracting quality human resource and experienced, influential channel partners. On the other hand, due to their proximity to the customer, flat management structures and the resulting flexibility, smaller firms are able to implement an efficient consumer response (Timm *et al.* 2001).

Again, due to their small size, entrepreneurial firms are well placed to customize their efforts to suit the needs of individual customers.

### Not Known to the Customers

New ventures are unknown entities to potential customers. This leads to a lack of trust in their abilities and offerings (Gruber 2004). Lack of exchange relationships in new firms is of concern even to distributors and suppliers.

#### Exhibit 13.1 Radical Marketing

In their book, *Radical Marketing*, Sam Hill and Glenn Rifkin outline the principles of radical marketing as follows:

- The CEO must participate directly in marketing. Radical marketing cannot be delegated.
- The marketing department should be flat and small. There cannot be multiple layers between the decision makers and the market.
- The customers are the ones who matter the most. Radical marketers must interact directly with the customers.
- Market research should be used cautiously. Only 'grass-roots' techniques should be used.
- Hire marketers who are passionate about the product and their job.
- Customers should be respected and loved. They are not merely numbers on a spreadsheet.
- Encourage customers to think of themselves as a community and of the brand as a unifier for that community.
- Keep thinking about the marketing mix and keep customizing it to suit requirements.
- Compete with larger competitors with fresh and different marketing ideas.
- Protect and nurture the brand.

Because of being new, an entrepreneurial firm has to make special efforts to build trust among its customers. Sometimes, in really badly served markets, a lack of track record can be turned into an advantage.

New ventures have not had the time to establish structures and processes. This helps in enabling a quick response to market changes.

## FEATURES OF ENTREPRENEURIAL MARKETING

To overcome their problems, entrepreneurial firms need to have a very proactive approach to marketing, which is reflected by the following characteristics of the marketing:

- Proactive orientation
- Innovativeness
- Focus on the customer
- Utilizing an opportunity
- Risk management
- Value creation

The above aspects of marketing have been identified by many management thinkers as the defining characteristics of entrepreneurial marketing.

### Proactive Orientation

Entrepreneurial firms are continually searching for new ways to achieve competitive advantage through changes in established methods in marketing or production (Morris and Sexton 1996, Zahra and Garvis 2000).

### **Innovativeness**

Innovative firms have the ability to maintain a flow of new ideas that can translate into new products or services (Covin and Slevin 1994).

### **Focus on the Customer**

An entrepreneurial firm is focused on the need for creative approaches to acquire, retain, and develop customers (Slater and Narver 1995, Deshpande, Farley, and Webster 1993). Paying attention to the consumer equips the entrepreneurial firm with a knowledge base of customer's requirements.

### **Utilizing an Opportunity**

The recognition and pursuit of opportunity is a core dimension of entrepreneurial marketing. Entrepreneurship has been termed as the process of discovery, evaluation, and exploitation of opportunities (Shane and Venkatraman 2000). Entrepreneurial opportunities are situations in which new goods, services, raw materials, and organizing methods can be introduced through the formation of new means, ends, or means-ends relationships (Casson 2003).

### **Risk Management**

Entrepreneurship is associated with calculated risk taking. This implies an effort to identify the risk factors and subsequent attempt to control or mitigate those risk factors. Entrepreneurial marketing has an important role in managing risk in the entrepreneurial firm (Srivastav, Shervani, and Fahey 1999).

### **Value Creation**

Innovative value creation is an important facet of entrepreneurial marketing, as value creation is a prerequisite for transactions and relationships (Morris *et al.* 2002).

## **MARKET RESEARCH**

Small firms are often unwilling to invest in market research as a market research exercise seems to be an expensive proposition. Moreover, it is a time-taking process and an entrepreneurial venture is usually in a hurry.

Many entrepreneurial ventures take a middle path and decide to undertake market research when there is a big decision to be taken. This is not necessarily the right approach. The question of when to resort to market research can be answered by a cost-benefit analysis. The costs of doing market research are the direct expenses of doing research as well as the probable loss in sales due to delaying the decision.

The benefit of market research lies in the increase in revenue by improving the quality of the decision. It is quite possible that the cost-benefit analysis may be against research even if stakes are high. A delay in the decision caused by waiting for the results of the market research can give an opportunity to competitors to capture market share at your cost.

Market research is not to be confused with a field survey. A field survey is just one of the techniques used in market research. Any reliable information that improves the marketing decision is market research. Some other sources of information related to the market research are discussed below.

### ***Systematic Observation***

It can comprise a variety of activities such as observing buying behaviour of customers in shopping places or observing the actual usage of the products by customers.

### ***Focus Groups***

These are made up of random or selected individuals who discuss a topic of interest to the researcher.

### ***Secondary Sources***

This refers to information from published sources such as magazines, journals, statistical outlines, archives, etc. This is the data that has been collected and is now available to others.

### ***Test Marketing***

Releasing the product in a small part of the market targeted is a good way for getting reliable information on customer's reaction to the product.

Market research is not a very difficult activity, but there is a high level of sophistication involved. The entrepreneur should be well acquainted with the basics so that he/she has an idea of what can be expected and how to achieve it. Usually, it pays to get the services of professionals to conduct the market research.

Even in the case of field surveys, there are some easy ways to cut costs, which should be seriously explored by the entrepreneur and his/her researchers. These are discussed here.

### ***Convenience Sampling***

In this case, the field survey is restricted to the individuals you have easy access to, e.g. existing customers.

## Exhibit 13.2

### Sources of Market Information

- Centre for Monitoring Indian Economy (CMIE) publishes a number of reports relating to the Indian economy and industry.
- The Annual Marketing White Book is published by *Businessworld*, a leading business magazine, and it is a very useful book.
- Indian Council of Applied Economic Research brings out a range of publications based on consumer surveys, etc.
- The *Statistical Outline of India*, published by Tata, is a small book that provides data summarized from a variety of sources. It is a very useful ready reckoner.
- The Department of Commerce, Government of India, publishes data relating to imports and exports of all products and services.
- The National Readership Survey and the Indian Readership Survey provide data on newspaper- and magazine-reading habits and also the readership base of a large number of national and regional publications. This is a useful publication for media planning and advertising.
- There are several websites that provide data relating to variety of topics. Some useful ones are [www.indiastat.com](http://www.indiastat.com), [www.indialaw.com](http://www.indialaw.com), [www.magindia.com](http://www.magindia.com), and [www.agencyfaqs.com](http://www.agencyfaqs.com).

### **Snowball Sampling**

Here, you ask respondents to suggest others who could also be respondents. This can be a unique way of finding rare populations. For example, if you have come out with a product likely to be of use to polo players, asking a polo player can be the best way to find other polo players.

### **Omnibus Sampling**

A lot of research organizations such as IMRB conduct surveys and come up with results and compilations that will be of interest to many organizations. Such reports can be purchased at a fraction of the cost of doing a fresh research. The cost per customer is low as costs are shared by many. The disadvantage is that the survey is not tailored to your needs.

### **Low-cost Surveyors**

Many NGOs and student bodies come forward to do research work. With proper supervision, they will be able to do a good job for a relatively less cost of hiring a market-research agency.

Results from a market research are useful, but the research is most valuable under the following circumstances:

1. The researcher understands decision alternatives and the information required.
2. The relationship between results and the decision is understood by the entrepreneur and the researcher.
3. The results are communicated well. Sometimes, the results can be cloaked in jargon and the researcher can fail to convey the true significance of the results.
4. The research design and planning is not poor. Otherwise, it can delay the research or can result in erroneous conclusions.
5. A lot of market research, particularly field surveys, is done under direct supervision and there is no scope to fudge basic data. With fudged data, the results will get skewed and a wrong picture will be presented to the client.

It pays to be careful with the results from a market survey. At best, it is a good estimate, but a number of factors can result in a good estimate that is nowhere near the actual market performance. Sometimes, the market-research agencies are also found to be optimistically overstating the results to get a favourable response from the clients.

One of the commonest reasons for entrepreneurial firms to conduct a market survey is to forecast market demand. There can be a lot of methods to arrive at a forecasted demand, but most methods are based on the following steps:

- Define the total market.
- Divide total demand into distinct market segments.
- Forecast drivers of demand in each segment.
- Match with own product to come up with possible sales of own product in that segment.
- Total the forecasted sales in the segments that can be profitably targeted.
- Conduct sensitivity analysis to understand assumptions.

## SEGMENTATION, POSITIONING, AND TARGETING

Conceptually, *segmentation* is the process of dividing the entire market into smaller groups sharing one or more characteristics that cause them to have similar product needs. Segmenting the market allows an entrepreneur to define consumer needs more precisely and that leads to formation of more accurate marketing objectives. For a large firm, segmenting allows for the customization of marketing mixes focused on each segment, but for an entrepreneurial venture, segmenting allows you to segregate the market between your focus segment and all others. With small size and limited resources, it is not wise to pursue multiple segments. The entrepreneurial venture must concentrate all energies on a selected segment. At most, some other segments can be kept in mind as follow-up segments.



There are several ways of segmenting the market. The popular bases for segmentation are geographical location, age, gender, income, and ethnicity. Entrepreneurs may also use benefit segmentation, which seeks to group consumers on the basis of benefits they seek from the product.

Selection of target segment is on the basis of matching the product attributes to the benefits sought by the segments. One important question to be answered is: Is your product able to deliver the value sought by a segment, better than the competition?

While selecting the target segment, it is also important to answer the following questions that determine the attractiveness of the segment:

- Can the segment be easily identified?
- Is the segment big enough in terms of the potential revenue?
- How easy is it to reach the segment with the positioning communication and with the product?

### Exhibit 13.3 Small Brands

In his book, *Eating the Big Fish: How Challenger Brands Can Compete Against Brand Leaders*, Adam Morgan offers eight ways for small brands to compete better:

- **Break with your immediate past:** Do not be afraid to challenge the convention and view your brand differently.
- **Build a 'lighthouse identity':** Establish values your brand stands for, e.g. Apple.
- **Assume thought leadership of the category:** Be unconventional in your brand message.
- **Create symbols of reevaluation:** Focus on getting people to rethink and change their existing attitudes.
- **Focus:** Know your target market and how to reach them.
- **Do 'Big':** Do a few things but let them be spectacular.
- **Enter the customers' consciousness:** Get people talking about your brand.
- **Be idea-centred:** Remain consistent with what your brand stands for.

*Positioning* can be expressed in a statement that explains why a customer should buy your product rather than that of the competitors. It refers to the unique differentiating characteristics of the product as perceived by the target segment. A fundamental concept is that the positioning should concentrate on benefits and not on product features. For example, a squash racquet can be positioned as having a graphite shaft, champagne glass shape, and composite gutting. The consumer will find it more appealing if the same racquet can be described as a very light racquet with a large sweet spot and capable of generating more power than conventional racquets.

## BRANDING

Given the lack of resources and limited marketing power of entrepreneurial firms, branding gets neglected by many start-up firms. On the other hand, countless business plans outline a strategy based on premium pricing. This sounds illogical. Premium pricing cannot be crafted in a vacuum. Premium pricing is possible only if the customer place a higher value on the product or service being sold. This, in turn, is made possible by having superior or desirable product features and getting the customer to identify those features as belonging to your offering. Branding your product becomes inevitable in those circumstances.

At the same time, larger multinational corporations have the luxury of huge brand-building budgets, which will not be the case with a start-up. So, one has to be very careful on how to spend money and how to get the maximum benefit for money spent.

### Major Considerations

The major areas of concern in a brand-building process are discussed here.

#### **Strategic Brand Building**

The brand is an important asset for the company and like all important assets, its maintenance and protection should be the concern of the top management. Here, in fact, the problem is further accentuated as the brand may be a very delicate asset in most circumstances. If the entrepreneur does not take personal interest in the management of the brand, it is likely that the brand is going to flounder. The brand strategy should be made an integral part of the firm's strategy, and there should be a long-term strategy on how to manage and grow the brand.

#### **Identity-building Brand Exposure**

The entrepreneurial firm cannot afford to have any wasteful brand exposure. It is not always true that any exposure is good. For example, it makes no sense if you are planning on setting up a high-end spa for women and you end up sponsoring the local *kabaddi* tournament. Even if attendance is good and your brand gets prominence during the event, it may not help to bring in a lot of customers.

The desired identity of the brand should be the foundation for the start-up brand-building programme. There should be consistency in the brand-building exercise and the communication received by the customer. Conflicting brand images can confuse the customer.

#### **Involving the Customer in the Brand-building Exercise**

In case of services, the customer can be heavily involved in the brand-building exercise. In the case of coffee parlours such as Café Coffee Day and Barista, the kind of customer

who is in the shop also contributes to the brand image. A close association with the creation or delivery of the service leads to a brand loyalty that goes beyond the kind of brand affiliation that results from mere usage. This is not easy to achieve, and those who have managed it have benefited tremendously. It is easier to achieve with niche products. Royal Enfield's loyal customer base is an example that immediately comes to mind.

Many larger companies have stretched the boundaries of how to involve the customer in brand building. Recently, General Motors ran a competition where potential customers designed ads for their latest SUV, the Tahoe. Mastercard tried something similar for their 'priceless' campaign.

Start-ups can involve their potential customers to design product configurations, communication campaigns, or even meaningful promotions.

### ***Borrowing Practices from Across Industries***

The brand-building practice that works to build brands in the construction industry may not be wrong for ready-to-eat packaged foods. Not just for brand building but also for other aspects of business, it is a good idea to borrow practices from across industries and across geographies.

### ***Pilot Testing Novel Ideas***

A radical new idea can do a world of good to your marketing effort, but in case it fails miserably on some front, it has an enormous potential to do a lot of harm. In the past, a manufacturer of packaged puja kits used a frivolous slogan – 'Use \*\*\*, make God happy' – and it had a very unfavourable impact on potential customers.

It is a good practice to test the acceptance of a brand-building exercise, especially if it is radical, on a small cross section of your target market before trying it out across the spectrum of your market.

### ***Having a 'Brand Manager'***

Someone has to be responsible for the brand. In case it is not the entrepreneur him/herself, it has to be someone senior enough or competent enough to get things done. If there is no 'ownership' of the brand, it is likely that the brand will not get continued support it needs, and in case of failure, there will not be anyone accountable for the loss.

### ***Monitoring Results***

What worked for a certain brand may not work for all the brands in your portfolio. Similarly, what worked for a brand last year may not be suitable for your brand right now. Results need to be constantly monitored to ensure that everything is

fine. If there are significant changes in the way other competing brands are positioning themselves, a shift in your own brand strategy may be called for.

### ***No Outsourcing***

Many ad agencies and other experts will offer to look after your branding strategy. It is not a good idea to outsource branding. First of all, it will create a distance between the brand and the entrepreneurial team. Next, the outside agency is likely to focus on the media, advertisements, and promotions but not on the brand itself. The money for the agencies lies in placing advertisements, not in building the brand.

### **Challenges in Building Strong Brand**

Aaker (1996) states eight reasons why companies find it difficult to build strong brands. Though this list was made keeping in mind large companies, these reasons hold true even for small entrepreneurial ventures. This section discusses these reasons in the context of entrepreneurial firms.

#### ***Pressure to Compete on Price***

The first adjustment that tempts an entrepreneur in the face of dropping sales is a drop in prices. To the market, a drop in prices will signal a drop in value.

#### ***Proliferation of Competitors***

The entrepreneurial venture is competing against other small firms as well as the large firms. There are going to be a number of new firms continually entering the market too. It becomes difficult to maintain this distinctiveness in the face of increased competition.

#### ***Fragmentation of Media and Markets***

The entrepreneurial venture has to keep a constant watch on the best and most cost-effective way of reaching the intended target segments.

#### ***Brand Relationships***

This refers to the brand's relationship with other brands of the same company. A small entrepreneurial venture can ill afford to divide its efforts among a number of brands. It pays to concentrate on only one. Even large successful companies such as Coca-Cola and Ferrari have grown largely on the strength of a single brand.

#### ***Bias Towards Changing Strategy***

As the venture grows, there will be a wish to move away from existing strategy. For example, in the early days, the entrepreneur would be more hands on in sales than

is possible in an organization that has grown significantly. This can adversely affect the brand.

### ***Bias against Innovation***

At the same time, there will be an inertia to stay with current processes and new innovations will be ignored. For instance, a firm may fail to react to the fact that most of its customers are now comfortable with the Internet transactions.

### ***Pressure to Invest Elsewhere***

This is a normal situation in a cash-strapped new venture. There will always be some other immediate expenditure that may take priority over brand-building expenses. The entrepreneur must take time and make a judicious decision.

### ***Short-term Pressures***

Sometimes, it can get very tempting to sacrifice branding to help short-term sales goals. In some occasions, the huge pressure on closing a sale may tempt a temporary sacrifice of branding, but it may have long-term implications.

## **PRICING**

Many entrepreneurs feel that pricing is an easy decision to make. For most of them, the basis of pricing is usually costs or competitors' price. This is a simplistic way of making a very important decision. Even though costs play a part in determining prices, they should not be allowed to be the cornerstone of your pricing policy. The significance of costs can be summarized in the following statements:

- Producer's cost indicates a floor price.
- Customer's cost is a sign of price sensitivity.
- Competitor's cost specifies its strength.

Competitor's prices are an indicator of the value the customer places on a product. It is the entrepreneur's outlook to ensure a positioning in the mind of the customer that enhances the value of the product in the entrepreneur's mind. As long as the product occupies a unique positioning, it is possible to shape the perception of the customer regarding the value of the product. Based on this premise, you can price the product using the following steps:

### ***Assess the Value***

Assess what value customers place on the product. This can be done by a variety of market research techniques.

### ***Classify Customers***

Look for variations in the way customers give importance to the product. Different classes of customers will put different values on your product offering such as:

- Heavy use
- Criticality of use
- Different uses

### ***Identify a Pricing Structure***

A price is not just a simple price point. There can be a lot of deviation in pricing the base offering and the price of add-ons. Variations can be there for different geographies, time of purchase, etc.

### ***Consider Competitor's Reactions***

Different competitors would have varied strategies for dealing with a new entrant. Not always will the reaction be a drop in prices. Usually, the reaction will have a lot to do with other elements of the marketing mix.

### ***Monitor Realized Prices***

The realized prices will have a lot to do with the effort involved in maintaining a certain brand image. For example, it may be possible to increase realized prices by dropping prices and doing away with after-sales support.

### ***Assess Customer's Emotional Response to Prices***

This has to do with customer's perception of the 'fairness' of the price of the product.

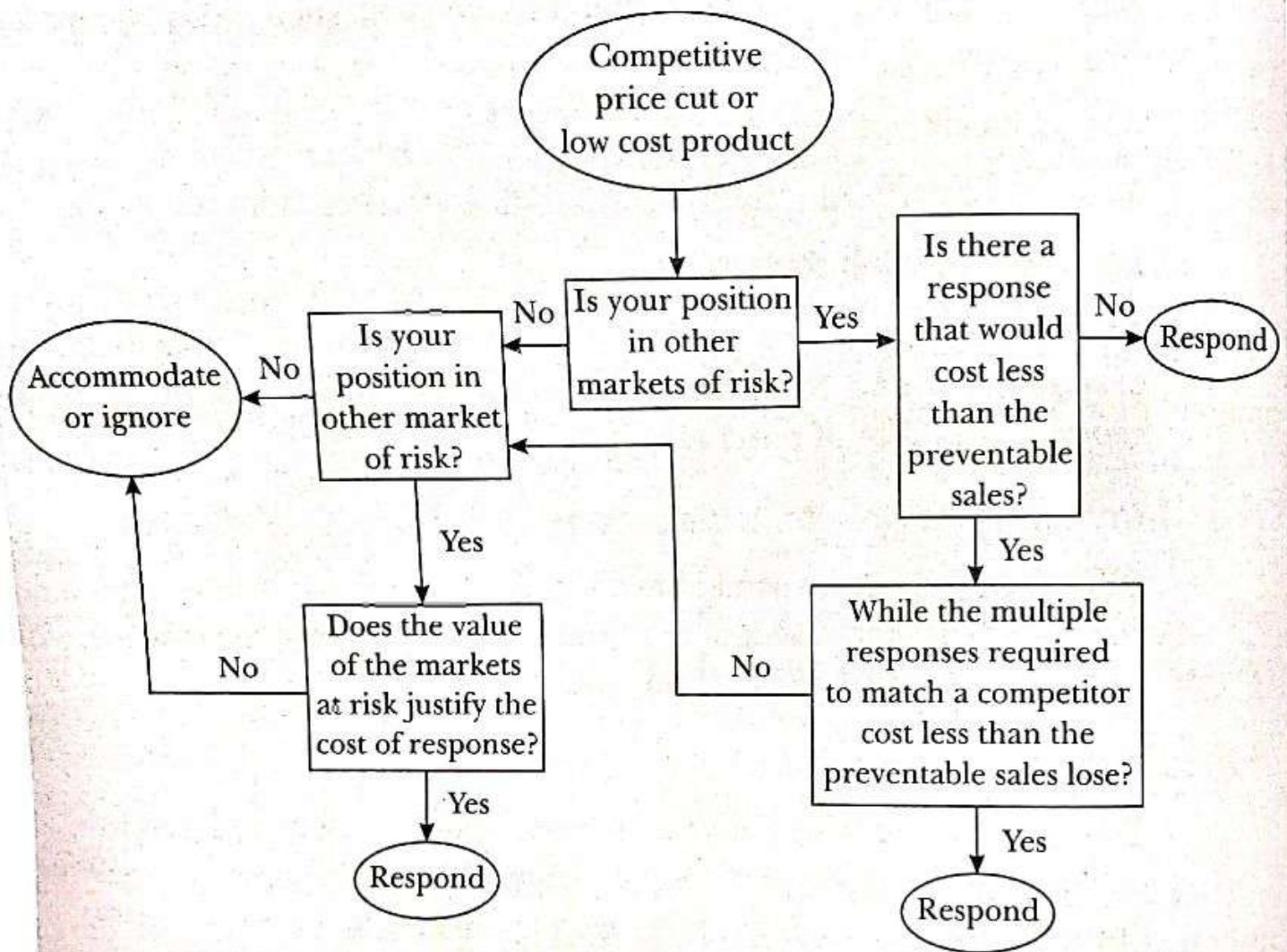
### ***Analyse the Worthiness of the Returns***

Analyse if returns are worth it. If a mistake has been made in pricing, it should be corrected before further damage is inflicted on the company. Periodical review of pricing is a healthy practice.

The following pricing considerations must be kept in mind while determining the price of a product offering:

- Pricing of a product should work towards maximizing present worth.
- The unit for making decisions and measuring returns is the entire economic life of the product.
- Pricing begins before production commences and re-pricing continues for the entire lifecycle.
- Different pricing strategies can be used in different segments.

## Exhibit 13.4 Reacting to a Price Cut



Source: George E. Cressman, Jr., and Thomas T. Nagle, 'How to Manage an Aggressive Competitor,' *Business Horizons*, 45 (Mar.-Apr. 2002)

### Price Sensitivity

One of the most important aspects to be taken into account while pricing is the price sensitivity of the buyer. There are some simple ground rules to get a rough idea of the price sensitivity of the buyer:

- Price sensitivity is less if a third party bears the cost. For example, in the case of many employees, since the company bears the cost of medical expenses, the individual is not likely to be bothered about the cost of a surgical procedure or a painkiller.
- Sensitivity is high when the cost of the item is a significant portion of the individual's total expenditure. On a shopping trip, there is a greater scope for making meaningful savings on the costlier items.
- Price sensitivity is higher in the case of business buyers as the buyer is not the end user. In some cases, the price may be passed on directly to the end user. In such instances, the business buyer may be less sensitive to prices.

- When there is no differentiation between the products available, it becomes easy to compare products in the category and the price sensitivity of customers increase.
- Price sensitivity is more when there is easy access to competing products. For example, if yours is the only product in its category in a supermarket, the customer has limited alternatives, but if there are four other competing products in the same shelf, the customer will be seriously looking at the price.
- Sensitivity decreases when there is a high cost of switching. For example, a person may consider buying a DVD if his/her existing equipment is DVD compatible. If not, even a very low priced DVD will not wean him away from buying a VCD.
- When a long-term relationship with the seller is not important, price sensitivity is low. For example, in purchasing consumer durables, people are willing to pay a higher price for better after sales service.

## **Pricing Strategies**

Broadly, there are two different pricing strategies—skimming and penetration pricing. These are followed by most entrepreneurial ventures.

### ***Skimming***

Skimming is a policy of relatively high prices where high prices are set to get very high margins. This is really effective when demand is comparatively inelastic with respect to prices. This may occur when consumers are ignorant of the real value of the product. Skimming serves to segment the market according to willingness to pay and systematic price reduction can be used to tap other segments. It is regarded as a safer strategy as it may be easier to reduce prices than to raise them. Some of its main advantages are that the high prices can be used to finance high initial costs and it can serve to absorb future rise in component costs.

### ***Penetration Pricing***

Penetration pricing is the strategy of setting low prices to get a large market share at the cost of margins. The loss in revenue by low margins is supposed to be offset by the higher sales. This strategy is highly effective under conditions of high-price elasticity of demand. This is usually implemented when the fixed costs are high and there is a very low variable cost. Sometimes, the current variable costs may not be low, but it is expected that the costs are going to decrease in the future. The cost-compression curve suggests that variable costs decrease with time when learning takes place in the production department and amongst suppliers. Penetration



pricing is also employed when there is a strong threat of potential competition. A higher market share serves to provide greater visibility early on.

### Exhibit 13.5 Demand-generation Tasks

	Lead generation	Qualifying sale	Presales	Close of sale	Post sales service	Account management	
Marketing Channels and Methods	Internet						CUSTOMER
	National account management						
	Direct sales						
	Telemarketing						
	Direct mail						
	Retail stores						
	Distributors						
	Dealers and value added resellers						
	Advertising						

Source: Rowland T. Moriarty and Ursula Morgan, 'Marketing Hybrid Marketing Systems,' *Harvard Business Review* (Nov.-Dec. 1990)

## DISTRIBUTION

*Distribution* refers to all the activities undertaken to transfer the product from the manufacturer to the consumer. The distribution channel is made up of various kinds of intermediaries such as retailers, distributors, wholesalers, and agents. These intermediaries fulfil a variety of functions. The structure of the distribution channel has to be decided first and foremost.

### Going Directly to the Consumer

As it is, there is a huge tendency on the part of entrepreneurs to bypass all and reach the customer directly. With the advent of the Net, this has become a very popular alternative. Using the Net is a natural choice if your product can be digitized

and distributed, for example, music, books, and software; but that does not mean that this alternative is restricted to these categories. Michael Dell used a business model dependant on reaching the customer directly and was able to grow Dell Computers into one of the leading PC manufacturers and he is now among the wealthiest people in the world.

Going direct to the customer is feasible in the case of many high-value items. Consumer durables, custom-made sports gear, and real estate are some big-ticket items routinely sold directly by the producers.

Another category that uses the direct route is services. Many service providers are not comfortable in outsourcing the distribution because, in many cases, the point of sale is also where the production takes place. For example, Café Coffee Day does not franchise its operations. All outlets are company owned and company operated. That is a very effective way of maintaining high-service standards.

Reaching the customer directly means that all the activities that were the responsibility of the distribution channel are now your direct responsibility. Appropriate investments have to be made to properly take care of those functions for a long time. Sometimes, new ventures can start off with a strategy involving going direct to the consumer and then as sales volume increase, bringing in intermediaries.

### **Going Directly to the Retailer: Bypass Distributor**

A traditional distribution system will have super-stockists, distributors, and retailers. Many entrepreneurs find it profitable to bypass the distributor and go directly to the retailer. This is a sustainable strategy, especially in the light of the current crop of retailers coming into the market. Organized retail in India is about 3 per cent of the total retail sale, but it is over 50 per cent in Western countries such as the US. Now, many big names such as Reliance, Birla, Pantaloon, and Walmart-Airtel are competing for a share of the Indian retail market. In this scenario, the power and role of independent distributors is going to decrease.

Ordinarily, there is no major scope of a distributor till a certain volume is achieved. So, an effective strategy could be to go directly to the retailer and once there is a certain volume of sales, an independent distributor can be contacted to take over the distribution. Naturally, it will be cheaper and easier to convince distributors to take on a product that is currently selling in the market than trying to convince them to sell a new untried product totally new to the consumer.

### **Using Sales Agents**

It is more appropriate to use agents when selling to businesses. Till volumes pick up, it will be costlier to rely on your own sales force. Even in the long term, many firms have found it profitable to have a company sales force that works in tandem

with sales agents. Sales agents are valuable because of their specialized knowledge on certain sector or certain regions. Also, in the case of B2B sales, losing one customer can make a huge difference to the total sales. It is wiser to split the contact with the customer between a company salesman and an outside agent. The firm is equally likely to lose the services of either and by having two contacts the risk of losing the customer is minimized.

The use of agents to sell high-value items in the consumer market is also very prevalent. It is common to see agents who are dealing in real estate, travel packages, and costly educational products.

### **Participate in Established Channel Structure**

Each region is likely to have many established distributors. These distributors have been dealing with retailers for a long time and have developed a working relationship with them. Some of these distributors will have specialized in certain product categories, but many others would be dealing with varied products. Many of them would have grown big and now would also be providing carry and forward services.

Making use of their services is a tempting alternative. It would immediately allow you to access a number of retail outlets and you would be associating with an experienced intermediary.

There can be a number of disadvantages in tapping existing established intermediaries. They would be willing to take on your product, but that would cause decrease in sales of their existing brands. For example, if you go to a distributor of P&G and ask him/her to stock your shampoo he/she will be immediately concerned that the sales of Pantene (a P&G product) will get affected. An alternative could be to go to a distributor who does not stock a similar product. For example, you could go with your shampoo to a Britannia distributor. This is a better strategy, but the established distributor will always place very stringent conditions while dealing with a new inexperienced manufacturer. Usually, he/she may ask for higher margins, longer period of credit, free samples, and for reimbursement of some market-related expenses.

### **Set Up Your Own Intermediaries**

A very good alternative is to set up your own intermediaries. It can even be friends and relatives. There will be some people known to you who wish to get into the distribution business; they can be persuaded to start with your product. Now, it should be kept in mind that if you have encouraged someone to start his/her business dependant on you, your responsibility towards that person is more. Practically speaking, if anything goes wrong, he/she is going to lay the blame on you.

Another way of doing this is if you have started by going directly to retailers, in time one of the retailers can be persuaded to take up the distribution function. This will work much better than bringing in an absolute novice.

## Deciding on the Distribution Channel

One of the main strategic decisions to be taken in relation to the distribution channel is deciding on the intensity of the distribution channels. At one end, there is the exclusive distribution option, while at the other end, there is the intensive option. Even though there are a lot of reasons to go for an exclusive channel strategy, most entrepreneurs do not consider that option seriously. Let us look at the distribution options available to the entrepreneur.

### **Exclusive Distribution**

Exclusive distribution gives the retailer an exclusive right to sell your product in a defined area for a period of time. There are several advantages of offering an exclusive distributorship. Some of them are given here:

- It is usually easier to find a distributor by offering territorial exclusivity.
- An exclusive dealership implies greater control over the activities of the retailer.
- With exclusivity, it is easier to maintain higher margins for all.
- There is less competition at the point of sale.
- The retailer will be willing to exert effort on 'pushing' your products to the consumers.

There are also some of the following disadvantages that have to be considered:

- The product receives less coverage in the target markets.
- The image of the retailer has an impact on the customer's image of the brand.
- By being your exclusive seller in a region, some bargaining power shifts in favour of the retailer.
- Some minimum guarantees have to be given to the retailer regarding local advertising spend and contributing towards the establishment cost by promising minimum sales.

One hybrid method is to give territorial exclusivity to a retailer and the retailer continues to stock competitor's products. This is not a very good idea as it leaves your product very vulnerable.

### **Intensive Distribution**

This is the opposite extreme of exclusivity. Anyone who wishes to stock your product is encouraged to do so. The objective is to reach the customer in as many ways as possible. This strategy is best suited for many fast-moving consumer goods (FMCG)

and for many fads. If an FMCG is widely available, the likelihood of sales goes up. Since a fad is not going to sustain for long, it is wise to cover many retailers and make the product widely available for its short shelf life. The advantages of having an intensive distribution are as follows:

- The product gets wider coverage in the target market.
- It is convenient for customers to find the product.
- Faster sales cycle is possible.

The disadvantages to be considered are as follows:

- You have lesser control over the retail operations.
- Since there is less push for the retailer, a consumer pull has to be generated.

### **Selective Distribution**

Midway between exclusive and intensive distribution options is selective distribution. In selective distribution, no single retailer has exclusive rights over an area, but retailers are not appointed indiscriminately. A few retailers are chosen to stock the product in a given region. Some of the positive attributes of exclusive distribution such as control over the retailer and an exclusive image, can be retained without sacrificing too much of market coverage. Many sellers of consumer durables, apparel, and other relatively high-value goods use this kind of distribution network.

## **ADVERTISING**

The terms viral marketing, buzz marketing, and word-of-mouth marketing are used interchangeably. Even though marketing literature distinguishes between these terms, all of these refer to marketing techniques that use pre-existing social networks to build brand awareness by encouraging people to talk about their brand.

Viral marketing is considered to be more effective than other traditional modes of communication. People tend to believe their social contacts rather than a message or an advertisement directly from the company as they believe that their contacts are not getting paid or receiving an incentive for spreading the word. One of the most successful viral marketing campaigns was by Hotmail. Every mail sent from a Hotmail account had a message at the bottom that said: 'Get your private, free email at [www.hotmail.com](http://www.hotmail.com)'.

Even the larger companies are abandoning old media strategies to try out buzz marketing. Some recent instances of use of viral marketing by large companies include the campaign to launch Gmail, Microsoft's campaign for Xbox 360, campaigns for the movie *Darna Mana Hai*, and for the serial *Jassi Jaisi Koi Nahin*. Let us look at the reasons for the growth of buzz marketing:

- Most recent studies show that word-of-mouth advertising is ten times more effective than through other media.
- Media is getting fragmented and ad clutter is rising. Companies feel the need to stand apart.
- Traditional forms of media are rising in cost. A 30-second slot during a cricket match on a TV channel can cost over ₹ 7 lakh.
- Too many marketers are making conflicting claims. The common man's trust in ads is coming down.
- Many new technologies provide the impetus for the acceleration of buzz marketing.

## **Creating Buzz**

Buzz is not generated automatically. There are a few simple principles to be followed while attempting to create buzz around your product. These are discussed here.

### ***Giving away Valuable Products/Services***

A very effective way to get people talking about your product or service is to give away valuable products or services. It can be your core product or service, or can be a sample. It may also work to give away some other product as a free gift. In some product categories, people have come to expect receiving it free of cost. For example, in video games, the strategy followed by many firms was to give a sample that did not perform like the full version, but many customers were happy using only the sample version. Now, the new strategy is to allow a potential customer to download the full game but restrict access to a specified period such as two or three hours.

### ***Giving People a Story to Tell***

People will repeat a story only if there is something special about it. They will take the effort of repeating something only if they feel that they are passing on exciting information and that will lead to an increase in their worth within the social group.

The stories can have themes based on any of the following:

- Taboo
- Unusual
- Outrageous
- Hilarious
- Remarkable
- Secrets

### **Proper Transfer Mechanism**

A proper transfer mechanism should be in place. If you are giving away something, let the receiving not become a task in itself. The transfer of goods should be as seamless as possible. Similarly, while passing on a message, the communicator should not have to make special efforts to be able to pass on the message. Usually, this means a prepackaged message, which is easy to understand.

- The entire self-replicating communication should be scalable. The problem in giving away a free gift is that it is useless for viral marketing unless it prompts people to talk about it favourably. The message should continue being passed on and care should be taken to ensure that the chain does not come to an end prematurely.
- The best would be to utilize existing communication networks rather than creating new ones. For example, in spreading the Hotmail message, no additional effort was needed by the users to propagate the message from Hotmail. The message used the existing modes of communication to spread itself.
- Take advantage of others' resources.

In addition to the above principles, a good buzz marketing campaign should try to do some of the following activities to make the campaign more effective:

- The opinion leaders within a targeted segment should be identified, and the initial campaign should be directed towards them.
- Rationing supply of free samples, etc. can be a good strategy to increase the perceived worth of the product. Google did it successfully for growing the user base of Gmail.
- Use of the product by celebrities can be a good selling point. Here, the emphasis should not be on endorsement but on capitalizing on their habitual use. A *parantha* seller in the famous *Paranthewali Gali* in Chandni Chowk has photographs of Jawaharlal Nehru and other eminent leaders enjoying *paranthas* at his shop. It is still the busiest shop in the street.
- There are many news channels, newspapers, and magazines. It is not too difficult to get into the news by carefully planning it out. Many business schools have drawn attention to their unremarkable programmes by quoting insignificant positions achieved in vague categories in obscure polls run by some magazines.
- Building a community around the product is the most effective way to build and sustain a buzz marketing campaign. There are several communities built around Apple's iPod. In fact, these communities have their own business models too such as [www.buymybrokenipod.com](http://www.buymybrokenipod.com).

### Exhibit 13.6 The Law of the Few

In his book, *Tipping Point: How Little Things Can Make a Huge Difference*, Malcolm Gladwell talks of three types of people who help spread an idea:

- **Mavens**—people who are knowledgeable about big and small things
- **Connectors**—those who know and communicate with a number of people
- **Salesmen**—those who are very persuasive by nature

### Myths of Viral Marketing

According to Renee Dye (2000), there are some common myths about viral marketing that need to be dispelled:

#### ***Myth 1: Only Outrageous or Edgy Products are Buzz-worthy.***

Not at all, but the product has to be unique in some respect, so that people have some reason to talk about it. It helps if it is a highly visible product. You would agree that it is easier to have a viral campaign for a new cap than for men's innerwear.

#### ***Myth 2: Buzz Just Happens.***

Buzz does not result from a stroke of luck. There has to be a conscious effort to generate and nurture buzz.

#### ***Myth 3: Best Buzz-starters are Your Biggest Customers.***

Not necessarily; the people who are better able to spread the word need not be the best consumers of the product. These are two distinctly different groups of people.

#### ***Myth 4: To Profit from Buzz, Act First and Fast.***

The first mover may have a market advantage, but those following up will also be able to profit significantly from well-designed buzz marketing.

#### ***Myth 5: Media and Advertising are Needed to Create Buzz.***

Media and advertising can help in buzz but overdependence on media defeats the very purpose of buzz. Take the example of Hotmail, which did not take the help of any external media.

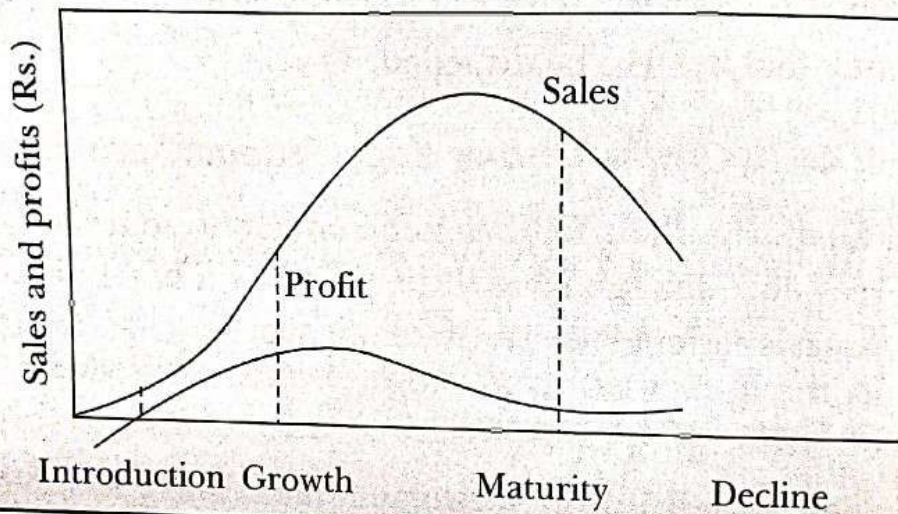
## PROMOTIONS

Promotion includes all activities involving communication with the customer. This includes all advertising, public relations, and promotional campaigns. In this section,



we will restrict the subject to dealing with promotional campaigns. Many of these promotional campaigns have been scoffed at by traditional marketing strategists as short-term measures aimed at immediate sales. For an entrepreneur, immediate sales are extremely important. The importance of ready cash cannot be underestimated and the value of cash in hand cannot be determined by simply using a time value of money analysis. Sometimes, adequate cash in hand can prove to be essential to ensure the survival of the venture.

**Exhibit 13.7**  
**The Product Life Cycle (PLC)**



Usually, for products that have achieved maturity in their product lifecycle, promotions have to be carried out to stimulate demand.

If short-term sales goals have to be achieved, it is better to use well thought-out sales promotions rather than to resort to arbitrary price cuts or aggressive push selling.

Short-term sales is not the only reason to start a promotional campaign, there are many other objectives too:

- Sales
- Increase in distribution outlets
- Increase in shelf space
- Increased in-store presence
- Expand the selling season
- Increase purchase frequency
- Increase usage occasions
- Increase average transaction size
- Induce trial

Before rolling out a promotional campaign, its planning is carried out in several sequential steps:

- Plan a promotional campaign.
- Establish its objectives.
- Plan on strategies and tactics.
- Establish criteria for success.
- Create back-up plan.
- Review and test.
- Put controls in place.
- Roll out.

## **Types of Promotional Campaigns**

There are various kinds of promotional campaigns an entrepreneur can consider. Some of the interesting alternatives are laid out along with a brief outline of their main features.

### **Contests**

Contests are used to call attention to a product when there is nothing new to announce about the product. It is important that the product should tie in with the contest. A photography shop will gain more by having a 'best photo' contest than by organizing a tug-of-war between its customers. A contest can also be a good way to build data on customers. An instant win situation, such as a scratch card, has a greater impact than a long-winded contest. It is always better to have lots of prizes than to have one big prize.

### **Coupons**

Coupons entitle their bearers to an immediate discount when presented to a participating business. The world over, coupons have been seen as the greatest influencer among all promos. P&G had a bad experience when people went to court after it stopped issuing coupons. Coupons can be issued by the manufacturer or the retailer or both. A coupon can be on the product itself, or it can be off site such as in a newspaper rebate coupon.

### **Discounts**

Discounts are given to stimulate demand in periods of low sales. Sometimes, a firm might discover that its discounted sales are much more than their normal sales. Discounting does result in increased sales, but it can also promote new kinds of consumption such as buying for gifting purposes. On some occasions, a discount only serves to prepone purchase and can result in postponing purchase in anticipation of a discount. A discount is easy to implement as price reductions are simple and easy to communicate.

### **Continuity**

The promotions based on continuity depend on the fact that it costs more to get a new customer than to retain an old one. Popular schemes are when you collect wrappers to trade in for a collectible or loyalty programmes run by hotels and airlines where you accumulate loyalty points based on usage or purchase. These programmes can be for a particular period or can continue indefinitely.

### **Point of Purchase**

Point of purchase, also known as point of sale, is a display tactic where some inducements are given to dealers to prominently display your product. It is not very useful if used all by itself and can yield good results if used in combination with some other promotion. The display unit must be able to communicate the message within three seconds. There are many new attractive self-shipping display units that are easy to set up.

### **Sampling**

Sampling is a very easy way to draw in customers. Some customers will buy because they liked the product and a few will also buy because they feel obliged to, after having sampled the product. Sampling has been used effectively in selling ice creams, cookies, perfumes, video games, and a host of other products.

There are a number of ways to do it sampling such as given here:

- Mailing the demos
- Offering the sample on the pack of another product
- Distributing in a store
- Making it available on the Internet
- Trial runs
- Samples being offered at trade shows, clubs, and promotional events

It is important to follow up after giving a sample. The sample can be administered by properly trained employees and not temporary hires. The effectiveness of the sampling scheme has to be monitored before spending more money on it.

### **Organizing Events**

It is very expensive to be officially tied in with an event that draws attention to itself. A better way to associate with the event is to do it unofficially. For example, Pepsi's 'Nothing official about it' campaign during the Cricket World Cup stole the thunder from Coca-Cola, the official sponsor. A new hair salon had a Dhoni look-alike contest during the India-Australia cricket series.

Placing products in stalls near or at the venue can be a good way of associating. Sometimes, licencing opportunities are not as expensive as they seem.

### **Free Gift**

Retailers in India hold that nothing motivates a shopper more than a free gift. There are a number of opportunities to add a free gift as given here:

- Packed along with the product
- As the container itself
- Charging a small cost for it
- Free gift can be given with a long-term commitment (subscription)

Some of the most memorable campaigns of iconic brands such as Binaca Toothpaste, Uncle Chipps, GoldSpot, etc., have been built around free gifts.

### **Trade Promotions**

Trade promotions are targeted at distributors and retailers and are done with the objective of getting new distributors, exploit seasonality, or secure their services for regionally focused marketing activities. Good performance by dealers is also rewarded by bonuses.

### **Partnership with Other Manufacturers**

Many promotions can be carried out in partnership with other small manufacturers. Some products such as a fruit juice and a pizza lend themselves very well to joint promotions. Such joint promotional activities can be beneficial if carried out in the right spirit.

## **Summary**

Marketing in a small, new venture is very different compared to how it is done in a larger firm. Very often, a small firm might fail due to marketing mistakes. Limited resources, small size, and newness are the main obstacles in marketing for a small firm. The main characteristics of entrepreneurial marketing include being innovative, proactive, and focused on the opportunity and the customer. This orientation helps overcome some of the problems associated with entrepreneurial marketing.

The benefit of market research lies in the increase in revenue by improving the quality of the decision.

Market research need not be restricted to field surveys; there are other ways of gathering useful information. Usually, entrepreneurial firms need to conduct a market survey to forecast market demand.

Segmenting the market allows the entrepreneur to define consumer needs more precisely and that leads to formation of more accurate marketing objectives. The entrepreneurial venture must concentrate all energies on a selected segment.

Having superior or desirable product features is not enough. To get the customer to identify those features as belonging to your offering needs branding.

Without the luxury of a big branding budget, small firms have to carefully spend money to craft a consistent brand image.

The value the customer places on your product has to be the basis of pricing and not just costs or competitors' price. The price sensitivity of the buyer also has to be taken into account while pricing. Broadly, the two pricing strategies followed are skimming (high prices) and penetration (low prices) pricing.

The distribution channel is made up of various kinds of intermediaries such as retailers, distributors, wholesalers, and agents. The entrepreneur has to decide if the current distribution system in the industry suits the venture or whether a new model has to be adopted. The entrepreneurial firm may seek to do away with several layers of distribution in an attempt to preserve market control or margins. The intensity of the channel can vary from intensive to exclusive or selective depending on the start-up's objectives and the positioning of its products.

The terms viral marketing, buzz marketing, and word-of-mouth marketing are used interchangeably, and these refer to marketing techniques which use pre-existing social networks to build brand awareness by encouraging people to talk about their brand. Viral marketing is found to be more effective than other traditional modes of communication. Buzz is not generated automatically. There are some basic principles to be followed in generating interest around your product that leads to buzz.

In order to gain short-term sales goals, it is better to use well thought-out sales promotions rather than to resort to arbitrary price cuts or aggressive push selling. Short-term sales is not the only reason to start a promotional campaign, there are many other objectives too. There are various kinds of promotional campaigns such as contests, sampling, discounts, etc. Many promotions can be carried out in partnership with other small manufacturers.

## Key Terms and Concepts

**Market research (MR)** The gathering and studying of data relating to consumer behaviour, purchasing power, etc.

**Focus group** A group of random or selected individuals who discuss a topic of interest to the researcher

**Secondary sources** The published sources such as magazines, journals, statistical outlines, archives, etc., which are used for acquiring information

**Sampling** The act of selecting a subset of a population for purposes of conducting research

**Forecast** To estimate or calculate in advance, using cues from the current situation and historical events

**Segmentation** The process of dividing the entire market into smaller groups sharing one or more characteristics that causes them to have similar product needs

**Targeting** Selecting a particular segment to concentrate marketing and sales efforts

**Positioning** A statement that explains why a customer should buy your product rather than that of the competitors

**Branding** The application of marketing techniques to a specific product or product line to increase the product's perceived value to the customer

**Niche market** A narrowly defined group of potential customers whose needs are not addressed by the mainstream sellers

**Price sensitivity** The change in demand by customers in response to a change in price

**Skimming** A policy of relatively high prices that are set to get very high margins

**Distribution** All the activities undertaken to transfer the product from the manufacturer to the consumer

**Viral marketing** Using the marketing techniques that involve pre-existing social networks to build brand awareness by encouraging people to talk about their brand (The terms *viral marketing*, *buzz marketing*, and *word-of-mouth marketing* are used interchangeably.)

# WORKING CAPITAL MANAGEMENT

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## Introduction

The management of working capital is an integral part of overall corporate management. In simple terms, *working capital is the amount of funds which a small-scale industry must have to finance its day-to-day operations.* It may also be regarded as that portion of an industry's total capital which is employed in short-term operations. Included in these operations are such items as stocks of raw materials and supplies needed for manufacture, stocks of finished goods awaiting sale, semi-processed items or components that will soon merge as final products, sundry debtors representing pending collections against credit sales and short-term investments.

## Definition

In simple terms, working capital is the amount of funds which a small-scale enterprise must have to finance its day-to-day operations. It is a short-term finance. An effective utilisation of working capital results in the maximisation of productivity and profits. A proper management of working capital synchronises the cash receipts and cash outlay, and a unit may function with minimum cash reserves.

The Accounting Principles Board of the American Institute of Certified Public Accountants, USA, has defined working capital as follows: "Working capital, sometimes called networking capital, is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total enterprise capital which constitutes a margin of buffer for maturing obligations within the ordinary operating cycle of the business".

## Objectives of Working Capital

An essential precondition for successful financial management is the establishment of sound and consistent asset management policies, covering fixed as well as current assets. An effective utilisation of working capital results in the maximisation of productivity and profits. Profitability and solvency are the twin objectives of working capital management; and these can be achieved by

striving to maintain a correct ratio between working and fixed capital. Such ratios will ensure a smooth and rapid flow of funds and enhance the efficiency and profitability of the enterprise. A proper management of working capital synchronises the cash receipts and cash outlay, and a unit may function with minimum cash reserves.

### The Objectives of Working Capital are:

- (1) The management wants maximum productivity and profits in the employment of capital. This is possible by striving to maintain a correct ratio between working capital and fixed capital.
- (2) The management has another objective and that is, to maintain a smooth and rapid flow of funds in order to enhance the efficiency of working capital or profitability of the enterprise.
- (3) If cash receipts and cash outlay synchronise, there is no need to maintain a cash reserve. In business, it would be a miracle to have such perfect coincidence and coordination between receipts and payments. Hence, an enterprise must have a sufficient cash reserve to meet all normal as well as abnormal cash needs.

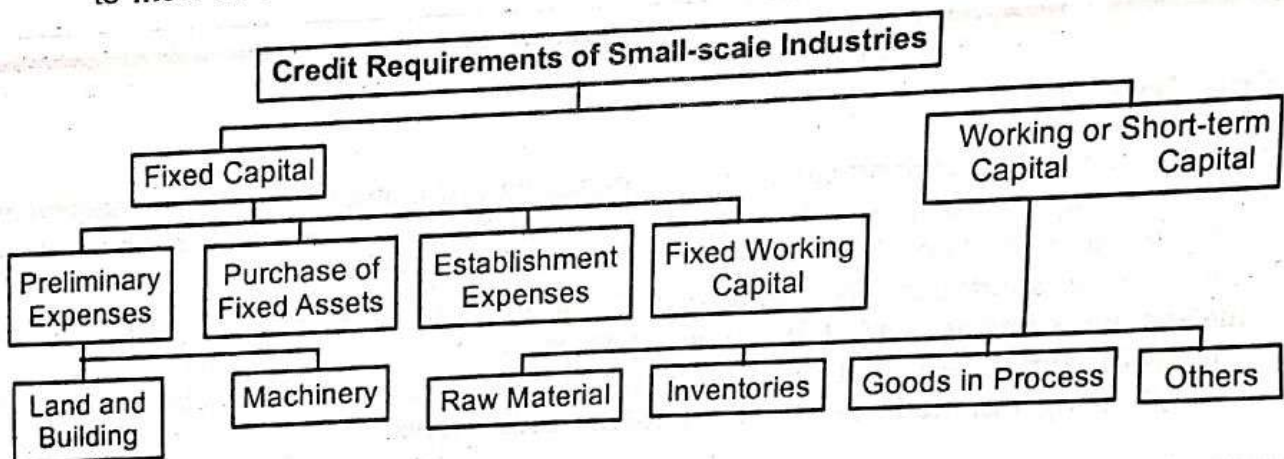


Fig. 21.1: Credit Requirements of Small-scale Industries

### COMPOSITION OF WORKING CAPITAL

For a proper appreciation and understanding of it, a closer look at the composition of working capital is necessary. The following are the constituent parts of working capital:

#### Current Assets

- Inventories
- Raw materials, components, etc.
- Work-in-progress
- Finished goods
- Others
- Loans and advances and other debtor balances
- Sundry debtors or trade debtors



Others, including prepayments

Investments

Government securities, semi-government securities

Industrial securities and others

} not applicable in the case of a small-scale industry

Cash and Bank balances

Fixed deposits with banks

Other bank balances

Cash in hand

Advance of income-tax (net of tax provisions)

} not applicable in case of smaller of the small-scale industries

### Current Liabilities

This includes borrowings for banks other than those against own debentures and other mortgages.

Other borrowings such as public deposits, loans, etc., other than those against own debentures and other mortgages at deferred payment liabilities (not applicable in the case of a large number of small-scale industries). They also include trade dues and other current liabilities, sundry creditors or trade creditors. Others include advances received, provisions, taxation (net of advance of income tax) and other current provisions.

The purpose of working capital is to achieve cash realisation, which is precisely explained below:

### Cash and Bank

- Short-term Loan.....
- Investment.....
- Sundry.....
- Debtors.....
- Finished Goods.....
- Work-in-progress.....
- Raw Materials.....
- Stocks.....

### Gross or Net?

The concept of working capital is broadly understood in 'gross' and 'net' concept. The financial is the 'gross' concept. The 'gross working capital' is represented by the sum total of all the current assets of the enterprise, while the networking capital (which is also known as the accounting concept) is the difference between both current assets and the current liabilities. In short, the gross and the networking capital concepts present two distinct and important facets of working capital management.

### Networking Capital

It represents the excess of total current assets over total current liabilities, and is measured by the current ratio. This indicates that current asset has an edge over current liabilities, viz., current assets < current liabilities.

Unit has the current ratio of a large ratio 2:1 which indicates greater solvency, while a very low ratio indicates insolvency.

$$\begin{aligned} \text{Networking Capital} &= \text{Current assets} - \text{Current liabilities} \\ &= (\text{cash} + \text{marketable} + \text{accounts} + \text{bills} + \text{inventories securities}) \\ &\quad \text{receivables} \\ &\text{Minus (-)} \\ &\quad (\text{accounts} + \text{notes and bills} + \text{expenses} + \text{temporary loans payable}) \end{aligned}$$

### Gross Working Capital

It is equal to the total sum of current assets and may represent both owned capital and loan capital.

The concept of gross capital is a financial concept, while that of net capital is an accounting concept. The distinction between gross and networking capital is summarised in Table 21.01.

**Table 21.1**

**Net vs. Gross Working Capital**

Net Working Capital	Gross Working Capital																																																																		
<p>Net Working Capital = Current Assets minus Current Liabilities</p> <p>Increase in bank loans cannot increase net working capital, retained profit, sale of fixed assets will increase networking capital.</p> <p>Net concept suitable for sole trader and partnership, where ownership, management and control are united.</p> <p>Net concept gives qualitative information about the company finances indicating its net liquidity. Long usage sanctions this concept. It is a concept very popular in accountancy system.</p> <p>It can point out the true financial position of a company even though both have the identical total capital</p>	<p>Gross Working Capital = Total Current Assets only</p> <p>Every increase in borrowing will increase the gross working capital. Under net concept, no change in working capital</p> <p>Gross concept is suitable for companies where we have separation of ownership from management. Managers are uninterested in the ownership of current or fixed assets.</p> <p>Gross concept gives only quantitative information about the company finances – total circulating assets.</p> <p>it is a concept very popular in financial management circles.</p> <p>It cannot reveal the true financial position of a company.</p>																																																																		
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**The Paradigm Shift in Working Capital**

	<i>The Old</i>	<i>The New</i>
Bank Finance	<ul style="list-style-type: none"> <li>● Maximum Permissible Bank Finance</li> <li>● Rigid Receivables Norms</li> <li>● Loan and Cash Credit Component</li> <li>● Fixed Prime Lending Rates</li> </ul>	<ul style="list-style-type: none"> <li>● Current-ratio Financing</li> <li>● Cash-flow Financing. Flexible Norms</li> <li>● Increasing Loan Component</li> <li>● Variable Prime Lending Rates</li> <li>● Short-term Foreign Current Loans</li> </ul>
Non-bank Finance (short-term)	<ul style="list-style-type: none"> <li>● Trade Credit</li> <li>● Bill Discounting</li> <li>● Inter-corporate Deposits</li> <li>● Public Deposits</li> <li>● Commercial Paper</li> </ul>	<ul style="list-style-type: none"> <li>● Trade Credit</li> <li>● Bill Discounting</li> <li>● Inter-corporate Deposits</li> <li>● Public Deposits</li> <li>● Commercial Paper</li> <li>● Euro-commercial Paper</li> <li>● Factoring</li> </ul>
Non-bank Finance (long-term)	<ul style="list-style-type: none"> <li>● Non-convertible Debentures</li> <li>● Equity</li> </ul>	<ul style="list-style-type: none"> <li>● Non-convertible Debentures</li> <li>● Equity</li> <li>● Floating Rate Notes</li> <li>● Note Issuance Facility</li> <li>● Revolving Underwriting Facility</li> <li>● Dutch Auction Notes</li> </ul>

**Total Working Capital**

Total working capital has two components – physical working capital (defined above) and financial working capital. Financial working capital includes cash in hand and at bank and net amount receivable (i.e., difference of amount receivable and payable) at the end of the accounting year. However, fixed deposits, for more than one year are not to be included in cash in hand and at bank. Long/medium-term borrowings taken for purchase of fixed assets are not to be included in the amount payable.

**Productive Capital**

Productive capital is the sum of fixed capital and total working capital.

**Objectives of Working Capital**

An essential precondition for a successful financial management is the establishment of sound and consistent asset management policies, covering fixed as well as current assets. An effective utilisation of working capital results in the maximisation of productivity and profits. Profitability and solvency are the twin objectives of working capital management; and these can be achieved by striving to maintain a correct ratio between working and fixed capital. Such ratio will ensure a smooth and rapid flow of funds and enhance the efficiency and profitability of the enterprise. A proper management of working capital synchronises the cash receipts and cash outlay, and a unit may function with a minimum cash reserve.

The success of a small-scale industry depends on the availability of adequate working capital, which ensures the purchase of raw materials at competitive prices and payment for labour.

## The Time Span

The two concepts of gross working capital and networking capital point to two distinct but interwoven sets of activity, namely, short-term and long-term financial operations respectively. The management of current assets involves short-term financial consideration, whereas the management of networking capital covers an extended time span, i.e., long-term financial considerations.

To obtain working capital, entrepreneurs should approach one of the commercial banks (State Bank of India or any of its subsidiaries, other nationalised banks, private sector banks, etc.)

Banks provide credit facilities to meet working capital requirements to facilitate production as per the manufacturing needs of the industrial unit.

Broadly speaking, working capital facilities could be classified as:

- (i) Lock and key pledge of stocks;
- (ii) Factory/mundy type/hypothecation advances (pending statement on stocks held by the unit to be intimated to the bank);
- (iii) Advances against stock-in-process;
- (iv) Advances against bills (when finished goods are supplied on credit);
- (v) Clean advances (contingent needs); and
- (vi) Packing credit to exporters to execute export orders.

As already stated earlier, banks provide both term-loan and working capital together in composite loans and also give small loans. Some entrepreneurs also depend on friends, relatives and other sources for their increasing requirements of working capital.

In order to get a loan from a commercial bank, the entrepreneur has to fill in an application form as per the specimen provided by the financial institutions, including banks and submit it to the bank along with the following documents:

- (i) Authentic copies of Balance Sheets and Profit and Loss Accounts (if the industrial concern is a limited company or an industrial cooperative society);
- (ii) A statement of assets and liabilities in the prescribed form in the case of partnership and proprietary concerns;
- (iii) Proforma statements in all other cases;
- (iv) Copies of the affidavit in regard to the size of the unit; and
- (v) Technical feasibility report from the Small Industries Service Institute, the Director of Industries, if obtained, may also be enclosed.

The total cost of the SSI project is computed as under:

- (i) The cost of fixed assets proposed to be acquired;
- (ii) Total working capital requirements (for the first year of production); and
- (iii) Preliminary and preoperative expenses. Provision should be made for escalation of costs.

The following are the sources for meeting the above cost of the project:

- (i) Your own capital, seed capital assistance from State Government/Development Corporations;
- (ii) Loans/deposits from your friends and relatives, which can be held for long periods, say, three years;
- (iii) Medium-term loans (for fixed assets) from the banks/term-lending institutions;
- (iv) Working capital loan from the bank;
- (v) Credit on purchases; and
- (vi) IDBI bill discounting for purchase of machinery on deferred payment guarantee.

Profitability estimates may be worked out using the format of the bank. The schedule of repayment proposed to be adopted should be based on the profit accounts. Cost overrun and time

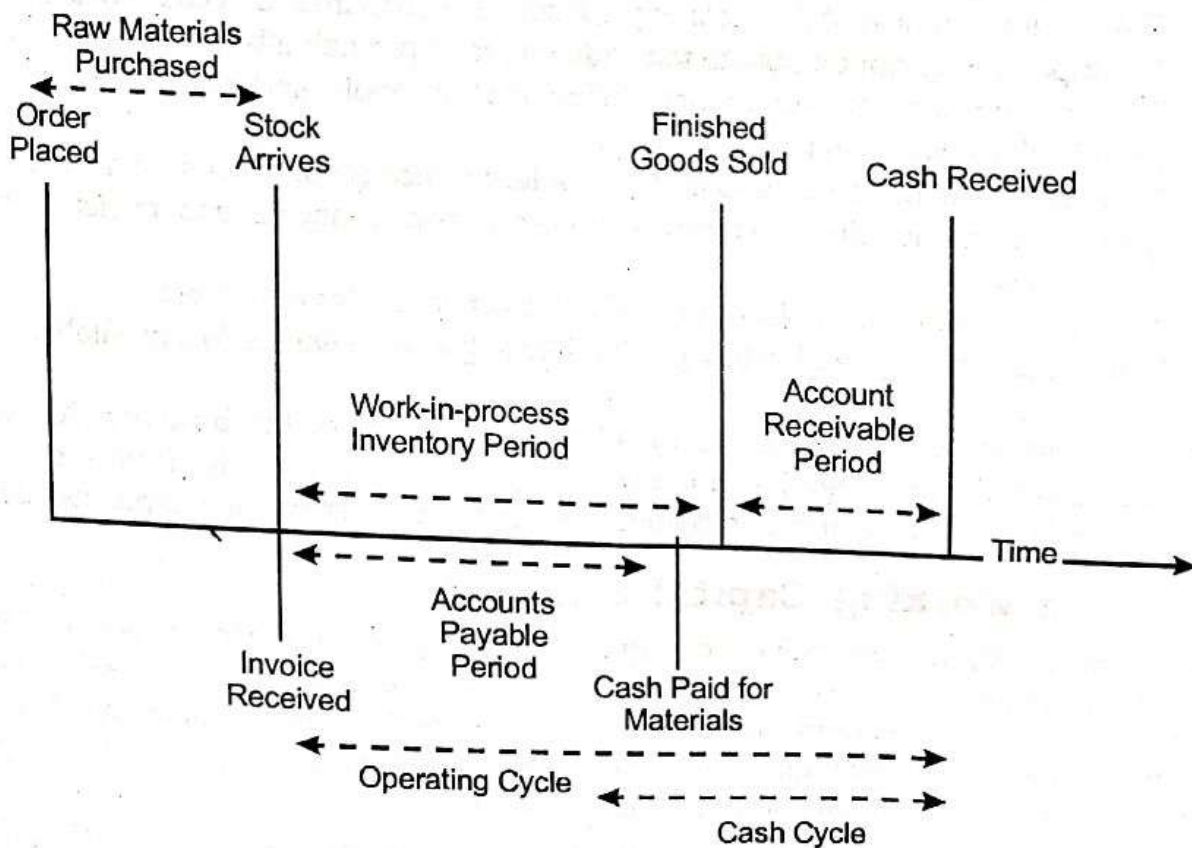
overrun are common in most SSI units. Careful planning must be done to overcome them so that the bank can process the working capital loan pragmatically.

## The Working Capital Cycle

The operating cycle begins with the arrival of the stock, and ends when the cash is received. The cash cycle begins when cash is paid for materials, and ends when cash is collected from receivables.

It has been rightly stressed that small-scale enterprises will have to learn to manage with a lower level of current assets to be globally competitive. Efficient working capital management techniques are those that compress the operating cycle. The length of the operating cycle is equal to the sum of the lengths of the inventory period and the receivables period. Besides, innovative financial instruments can also be deployed to churn over the current asset portfolio with greater speed. The entrepreneur may resort to bill discounting, factoring, etc.

Both core and variable working capital are supported by a mix of spontaneous current liabilities (trade credit and provisions for taxation), short-term financing (bank finance and short-term marketable securities), and long-term financing (long-term debt and equity). Since trade credit and accruals for tax payments are determined by exogenous factors, the crucial aspect for any working capital financing strategy is determining the proportion of current assets that is to be funded by short-term sources of finance.



## Adequacy of Working Capital

Working capital should be adequate for the following reasons:

- (i) It protects a business from the adverse effects of shrinkage in the values of current assets.
- (ii) It is possible to pay all the current obligations promptly and to take advantage of cash discounts.

- (iii) It ensures to a greater extent the maintenance of a company's credit standing and provides for such emergencies as strikes, floods, fires, etc.
- (iv) It permits the carrying of inventories at a level that would enable a business to serve satisfactorily the needs of its customers.
- (v) It enables a company to extend favourable credit terms to customers.
- (vi) It enables a company to operate its business more efficiently because there is no delay in obtaining materials; etc., because of credit difficulties.
- (vii) It enables a business to withstand periods of depression smoothly.
- (viii) There may be operating losses or decreased retained earnings.
- (ix) There may be excessive non-operating or extraordinary losses.
- (x) The management may fail to obtain funds from other sources for purposes of expansion.
- (xi) There may be an unwise dividend policy.
- (xii) Current funds may be invested in non-current assets.
- (xiii) The management may fail to accumulate funds necessary for meeting debentures on maturity.
- (xiv) There may be increasing price necessitating bigger investments in inventories and fixed assets.

When working capital is inadequate, a company faces the following problems:

- (i) It is not possible for it to utilise production facilities fully for want of working capital.
- (ii) A company may not be able to take advantage of cash discount facilities.
- (iii) The creditworthiness of the company is likely to be jeopardised because of lack of liquidity.
- (iv) A company may not be able to take advantage of profitable business opportunities.
- (v) The modernisation of equipment and even routine repairs and maintenance facilities may be difficult to administer.
- (vi) A company will not be able to pay its dividends because of the non-availability of funds.
- (vii) A company cannot afford to increase its cash sales and may have to restrict its activities to credit sales only.
- (viii) A company may have to borrow funds at exorbitant rates of interest.
- (ix) Its low liquidity may lead to low profitability in the same way as low profitability results in low liquidity.
- (x) Low liquidity would positively threaten the solvency of the business. A company is considered illiquid when it is not able to pay its debts on maturity. It must be wound up under Section 433 of the Companies Act, 1956, upon its inability to pay its debts.

### **An Aggressive Working Capital Strategy**

On the other hand, a conservative working capital strategy carries high levels of current assets in relation to sales. Surplus current assets enable the enterprise to absorb variations in sales, production plans, and procurement time without disrupting production rhythms. In the circumstances, efficient working capital management techniques are those which compress the operating cycle, inventory management and the use of innovative financial instruments.

A frantic burst of innovation will be the dominant characteristic of working capital finance in the next millennium. There has already been a revolution in the equity markets, and we are in the midst of a bustling expansion of debt markets. Yet, as bank finance was simply the be-all and end-all of working capital, finance short-term financing strategies remained static. No longer the forces unleashed by incremental reforms over the past six years, are freeing the price of capital, and the interlocking money markets. For the entrepreneur, the long-awaited big bang in the working capital market may finally be here.

## FACTORS DETERMINING THE AMOUNT OF WORKING CAPITAL

The working capital requirements of small-scale industries vary from one unit to another and from one type of unit to another type. Small-scale units, which are located in rented premises and are engaged in processing works, need a larger amount of working capital than other units. The other important factors that determines the amount of working capital are:

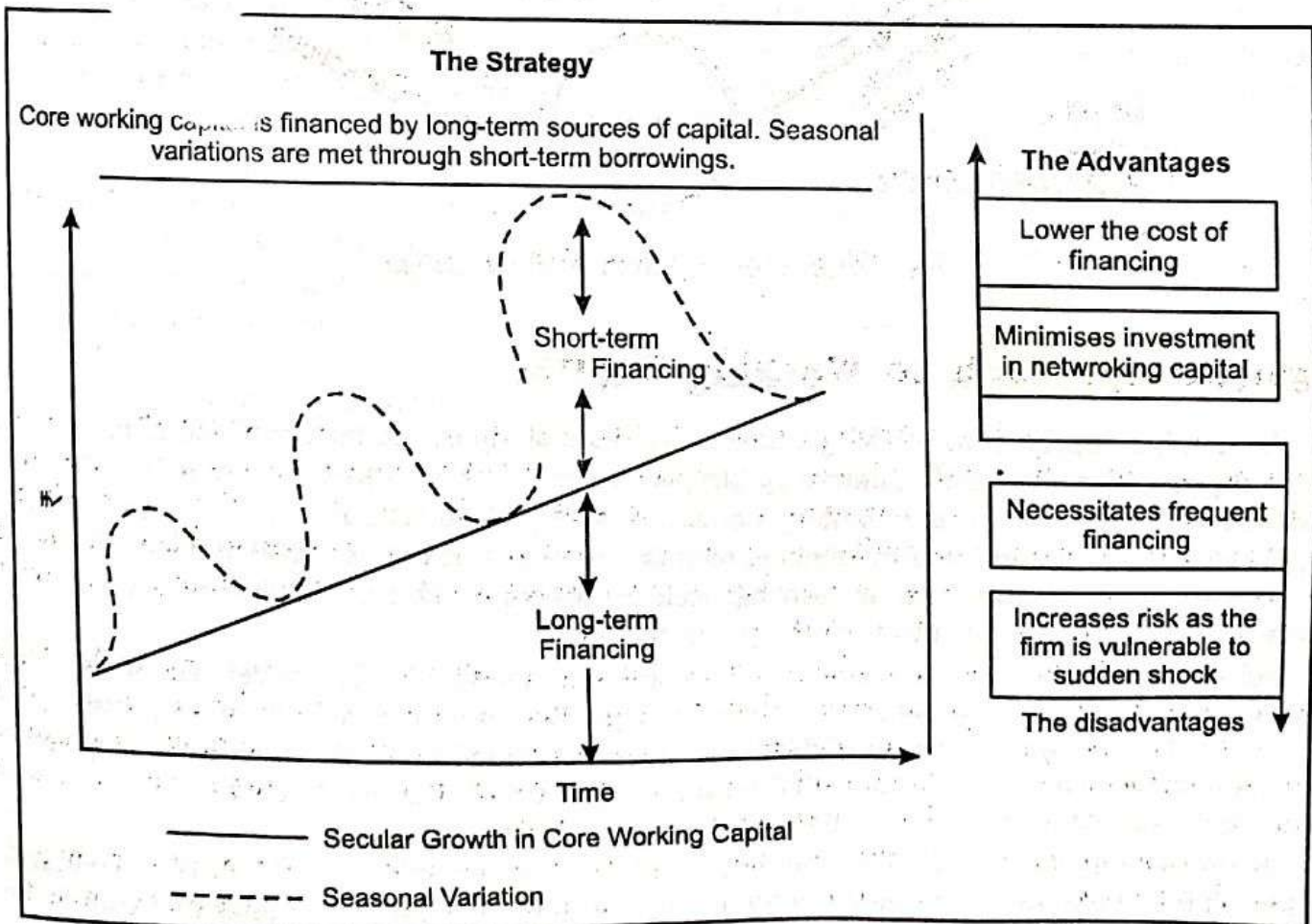
**(i) Size of the Small-scale Unit:** The amount of working capital depends directly upon the volume of business. The bigger the size of a unit, the larger the amount of the working capital and *vice versa*.

**(ii) Process of Production:** Simple short-period processes of production require a smaller amount of working capital and *vice versa*.

**(iii) Proportion of Raw Materials to Total Cost:** The price of raw materials and the quantity required determine the amount of working capital.

**(iv) Terms of Purchase and Sales:** The amount of working capital varies directly with the use of credit and *vice versa*.

**(v) Turnover of Inventories:** If inventories are large and their turnover is slow, a small-scale industry will need a bigger amount of working capital. If they are small and their turnover is quick, the unit will require a smaller amount of working capital.



**(vi) Importance of Labour:** Small-scale and cottage industries are labour-intensive units and therefore require a larger amount of working capital.

**(vii) Cash Requirements:** The amount of working capital required varies directly with the cash requirement of a unit.

(viii) **Seasonal Variations:** Seasonal small-scale industries require a large amount of working capital during the season in which the scale of operations is higher.

(ix) **Banking Facilities:** If a small-scale unit has a good banking connection, it may have minimum margin of regular working capital over current liabilities.

(x) The requirement of working capital varies directly in proportion to the growth and expansion of a small-scale unit.

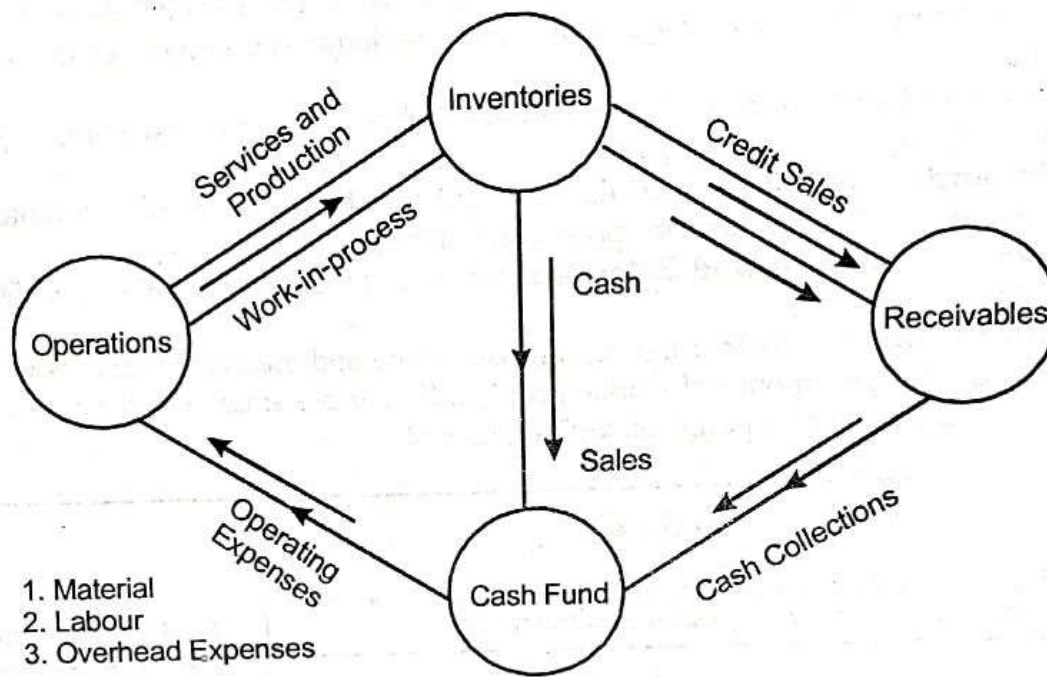


Fig. 20.2: Flow of Gross Working Capital

## Scientific Approach to Working Capital

A scientific approach to working capital involves a study of the factors which affect the need for working capital – the terms offered by suppliers, the terms offered to customers, the average period of lead time for various inventory items, the seasonal fluctuations in sales, the production cycle, the level of stock and other influencing factors. These factors may be used to relate the balance sheet items to sales volumes. The relationship yield measures which may serve among other things, as tools for the prediction of future working capital needs.

For a scientific study of the working capital problem, a mathematical model may be developed to state the important quantitative relationships among different variables. In order to construct such a model, it is necessary to make an objective study of the situation. In the case of working capital, the relevant factors which should be studied are the relationships that exist between the amounts of current assets and current liabilities, and the volume of sales.

In developing the model, the first step is to analyse the relevant factors of a company's situation. This involves an examination of the records, a study of actual procedures and consultation with company officials.

The suggested method of forecasting working capital need is an improvement on the methods which are currently employed by companies. The use of the model would result in a more accurate forecast, allow for improvement through observation and experience, and act as a useful tool for the assessment of the size of the working capital.



The use of the working capital model is appropriate for many types of business. In companies which manufacture different types of products involving different materials or different processes, separate sub-models may be constructed, and these may be combined in the final analysis. Where conditions are changing rapidly, the effects of the changes can be estimated objectively.

As long as the general pattern of the production and financial process does not change substantially, the model will hold good. When any change occurs, a restudy of the pertinent items would be sufficient.

In most cases, this type of working capital model can be developed easily. It would enable managers to forecast the level for each working capital item and ensure that the necessary resources are available. In addition, the model could establish working capital standards. A comparison of the actuals with the standards would provide a measure of the efficiency of financial management.

It is evident that if the advance signals thrown up by cash planning are constructively acted upon, most of the problems of cash surpluses and deficits would be resolved by suitable and marginal readjustments in internal operations, without affecting the short-run profit goals.

## Term-loans to Small-scale Industries

For several reasons, the somewhat comprehensive criteria which are applied to term-loan applications from medium and large-scale industries cannot be used in respect of term-loan proposals from small-scale industries. These industries find it difficult to secure adequate finance from institutional sources even for their working capital requirements because of their own inherent limitations on the one hand and the generally high standards applied by the lending institutions to borrowers on the other. Organised credit institutions have generally been wary of lending to these industries because, in their eyes, they are generally not of much risk. By and large small units have a low capital to turnover ratio, as a result of which the available block capital security is inadequate in relation to a given level of production; their markets are somewhat narrow, the prospects for business frequently uncertain, and their rate of mortality rather high. Banks, therefore, find it difficult to assess their creditworthiness. In these circumstances, these industries deserve special treatment, because of their relatively high employment potential.

**Difficulties in Procuring Institutional Finance:** Small-scale industries are generally not regarded as sufficiently creditworthy because they are not able to satisfy the criteria laid down by lenders. The grant of medium and long-term loans involves not only an assessment by the lending agency of the creditworthiness of the borrowers and the security offered by them, but also an observance of rules and regulations governing such advances. The financial position of a borrowing concern should be fairly sound and should show profit, or should have the prospect of improving its earning capacity, if financial assistance is granted; the equipment and technical processes employed in the production of goods and services should be efficient; the unit concerned should have an assured market or should produce items which are required by a big industry; and the borrowing concern should be owned by men of integrity and business standing. An assessment of the risk factor in advancing to small industries naturally poses a problem for the lender. Some of the more important difficulties are listed below:

- (i) Some rigidity in the approach on the part of lending institutions in dealing with borrowers and the absence of a close association with them;
- (ii) The complicated nature of the information required for the borrowers;
- (iii) Strict requirements of security and a rigid prescription of acceptable collateral, and
- (iv) Delay involved in the sanction of loans.

The institutions which normally respond to some extent to the needs of small-scale industries are the smaller banks, whose field of activity is restricted to a small area. These banks are often managed by local men who unlike the branch agents of big banks are able to develop informal relationships with the small industrialists. In view of their personal contact with customers, local banks are able to adopt a flexible attitude and expeditiously dispose of the applications for loans. However, the resources of these banks are limited; and unless bigger banks take a promotional view in the initial stages and extend the much-needed assistance to small industries, the latter would be forced to borrow from institutional lenders, the disadvantages of which need no elaboration here. As a consequence, they would fail to raise their standard of operations, which alone can help them to develop and become creditworthy. On their part, the small industrialists should appreciate the fact that banks have to operate on business principles and cannot lower their lending standards to any appreciable extent in order to meet their financial needs. They should, therefore, make earnest efforts to meet the requirements of lending institutions.

**Application Forms:** It is usual for some credit institutions to require an applicant for finance to fill in a very elaborate questionnaire. In this connection, it is suggested that, in the first instance, only such information may be obtained as would enable the lending institutions to judge whether a unit is creditworthy and the project for which finance is required is *prima facie* feasible. In other words, the information called for should be comprehensive enough, without being too detailed, to assist lending institutions to judge whether a proposal should be accepted for further detailed examination. In the preparation of the application form, the fact that most of the small industrialists do not have audited or published accounts, has been taken into account, and this would explain why Section B of the form dealing with the financial position of the borrower is somewhat more detailed. If, on an examination of this application, it is found that there is a *prima facie* case for the acceptance of the proposal, additional information in greater detail may be obtained either by a supplemental questionnaire or by the interview method, which may be suitably adopted by the investigator, having regard to the circumstances in each individual case. The intention for an experienced official should be to gather supplemental information or help the applicant in filling up the form.

**Audited Accounts:** As many industrial units are either proprietary or partnership concerns, it is usually difficult to obtain financial statements from them in an acceptable form. In such cases, some latitude may be shown to deserving units. For example, when a concern is unable to furnish audited account for the last few years, the latest account should be audited and presented to the lending institution.

**Personal Inspection:** Before a loan appraisal is completed, it is desirable that an experienced officer of the financing institution should inspect the concern so that a proper evaluation may be made of the proposal in the beginning. Small industrialists do not often know how to present their case to the satisfaction of the lending institution. It will therefore be useful if the latter, having regard to the circumstances of each case, provides the requisite guidance to the unit. Sometimes, slight modifications in the project, if agreed to by one unit, may make the application for a loan acceptable.

### Suggestion of Improving Facilities for Institutional Finance

If institutional credit is to play a vital role in catering to the requirements of these industries, measures will have to be taken to overcome the difficulties pointed out here. This calls for a responsive cooperation between the lenders and the borrowers. The nature of adjustment in attitudes and other matters necessary on the part of the lending institutions on the one hand and borrowing units on the other is indicated below.

## A. Lending Institutions

Some suggestions, which may be useful for lending institutions catering to the needs of small-scale industries, are given below:

- (1) Lenders should take into account not only the value of the security offered but also the character and technical ability of the borrower, the prospects for the industry, the nature and quality of goods produced, etc.;
- (2) The acceptance of only a few commodities as security and that, too, on a pledge basis, makes it difficult for industries to become eligible for advances from lending institutions. Wherever possible, factory type advances may be given;
- (3) Small and medium-sized banks which, individually, cannot afford to maintain a technical staff (engineers, business technicians, etc.), may join together and set-up a common advisory board for the purpose. One of the solutions is to utilise the services of the State Department of Industries and the Small Industries Service Institutes which, under instructions from the Government of India, offer assistance to credit institutions in the matter of technical appraisal of projects;
- (4) Lending institutions may maintain personal contacts with borrowing units through periodical visits, etc., and
- (5) In order to solve the problem of the paucity of technical data required for an appraisal of the creditworthiness of an industrial unit, it would be advisable to make use of the available official data on small-scale industries.

Some of the sources that may be tapped for this purpose are:

- (a) Data released by the Development Commissioner and the Ministry of Commerce and Industry.
- (b) Reports on studies conducted by the Small Industries Service Institutes, and
- (c) Industry reports prepared by the Economic Investigation Division of the Central Small Industries Organisation.

The division also offers investment guidance and advice on the prospects for various industries. Moreover, it has taken up the preparation of Industry Prospect Sheets on a large number of industries, which are miniature analysis of planning reports, and contain information on the technical feasibility of an industry, its competitiveness and the size of this investment, its supply-demand position, etc. As these sheets generally become outdated with the lapse of time, they have to be used with due caution, available from all these sources may be supplemented by the data furnished by the borrowers.

- (6) The interest charges should be reasonable and the period of repayments should be determined with reference to the earning capacity of a unit. The first instalment may be claimed after a year or two to enable the borrower to stabilise his position and strengthen his repaying capacity. The margin of security should be liberal; varying between 25 per cent and 50 per cent, consistent with the safety of the loan.
- (7) To enable financial institutions to liberalise their lending criteria, the Government of India has introduced the Credit Guarantee Scheme, operated by the Reserve Bank of India, which enables them to avail themselves of the guarantee facilities to cover a part of their risk. The maximum amount of loss recoverable under the scheme is ₹ 1 lakh, which is substantial in relation to the size of a small unit. Such guaranteed loans, if given on a term basis, are eligible for the refinance facilities offered by the Refinance Corporation.

- (8) The different agencies may supplement one another's resources and share the risks collectively by participating in the loans of other agencies. Participation on the part of commercial banks and State Financial Corporations and of bigger and smaller banks would be useful. Such participation loans can also be covered under the Credit Guarantee Scheme referred to above, provided that one of the participant institution is an eligible institution and undertakes to assume the risk of loss of loans to the extent of at least 25 per cent.
- (9) Lending institutions should be practical and flexible in their attitude rather than strictly legal, with a view to enabling the borrowing units to overcome any temporary difficulties. While resorting to legal action or recourse to security should not be delayed once it becomes clear that the loan cannot be recovered, such a drastic step should not be taken immediately on a default in payment of interest or instalment occurs. Not infrequently, defaults occur due to circumstances beyond the borrower's control. Timely advice and guidance and even the provision of additional financial assistance where so warranted, would enable him to tide over the crisis. Only when other avenues have been explored without result, or the borrower is considered to be recalcitrant or dishonest, should the lending institution force a closure.

## B. Small-scale Industries

There are joint directions in which small-scale industries may improve their method of operation, etc., and make their proposals acceptable to lending institutions. These are:

- (i) It may not be usually possible for small industries to furnish financial and other data in a thorough and detailed manner. In such cases, as much information as is available on the following aspects of the concern may be given to lending institutions:
  - Details of the nature of the industry and its products;
  - Data regarding performance, estimated cost of production and selling price;
  - Estimates regarding market prospects, capital invested, proportion of borrowed capital; and
  - Purpose of the loan, result expected from the investment, etc.
- (ii) Concerns should, in their own interest and in order to facilitate the assessment of loan proposals by lending institutions, try to maintain audited accounts;
- (iii) The units must be able to produce acceptable evidence for verification of the value of assets offered as security;
- (iv) Loans sanctioned should not be used for purposes other than those for which they have been advanced; and
- (v) In cases where the prospects of an industrial concern depend on a single individual, and where the loan is given on personal security or guarantee, the lender's interest may be safeguarded by insuring the life of such an individual during the loan period. Policies may be specifically devised for the purpose at special rate, somewhat on the lines of fire insurance. The premiums may be borne by the lending institutions or partly by them and partly by the borrowers.

## Conclusion

The working capital management is an integral part of the overall management of small-scale industries. There is a need for greater coordination between of small-scale industries and financial

institutions. Towards this direction, the Small Industries Development Bank of India (SIDBI) is shaped to provide a strong support to small-scale industries.

It is essential that financial institutions should safeguard their interests with adequate security. At the same time, small industrial concerns should not, as far as possible, be denied the assistance they deserve or need. Lack of finance is often not the cause but the result of difficulties in other areas. In such cases, what is needed is measures to set right those factors which would render financial assistance fruitful. It is common knowledge that small-scale sector needs non-financial assistance, marketing assistance, technical guidance and training in management, etc. In order to assist it, the government has already established special institutions like the Small Industrial Service Institutes, the National Small Industries Corporation and industrial estates with necessary facilities. It has also arranged training programmes for small entrepreneurs; but the scope of operations of these need to be expanded. Above all, there is need for greater coordination at all levels between the financial and non-financial institutions and agencies engaged in the promotion of small-scale industries.

In the present Indian context, the socio-economic obligations of a banker include identification of project ideas, formulation of projects, location of managerial talent and provision of technical and managerial guidance to new ventures with a view to broad-basing entrepreneurial talent and assisting in the creation of more employment opportunities in the country. The banker who controls credit is a 'supply leader' as opposed to his erstwhile role of a 'demand follower'. He is no longer a 'wholesale' banker sitting in an ivory tower. His new role as an agent of economic development is to assist in the development growth of economic activities.

Planning and control of working capital centres round cash planning which includes setting of cash policies and procedures and the control over cash and credit. Cash is of course the very sensitive component of working capital. The working capital has, therefore, to be managed properly, especially by the small-scale industries, because over or undercirculation may create volatile problems.

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# CONCESSIONS AND RELIEFS BY THE CENTRAL GOVERNMENT

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## Introduction

A number of concessions, reliefs and incentives are offered by the Central Government in India to the small-scale industries because they fulfil two important objectives of economic development. Firstly, they facilitate the decentralisation of economic power by encouraging prospective entrepreneurs to take up industrial ventures and assist in the dispersal of industries over the entire geographical area of the country. Secondly, they facilitate the transformation of a traditional technology, which is characterised by low skill, low productivity and low wages, into a modern technology, which is characterised by improved skills, high productivity, rising wages and a higher standard of living. Incentives and subsidies serve as a catalyst to start a dynamic process of development. They also influence the location of enterprises and contribute to regional distribution and development.

The Ford Foundation Team, which visited India in 1953-54, suggested a positive programme for the development of modern small-scale industries. Based on the recommendation of this team, the government provided a broad base of infrastructural and institutional set-up for the accelerated growth of small-scale industries.

In the present chapter, an attempt has been made to indicate the concessions, reliefs and the incentives which are available from the Central Government.

## Incentives

The term 'incentive' means encouraging action. It is a motivational force which makes an entrepreneur take a right decision and act upon it. Broadly, incentives include concessions, subsidies and bounties. Economic incentives – both financial and non-financial – push an entrepreneur towards decisive decision and action.

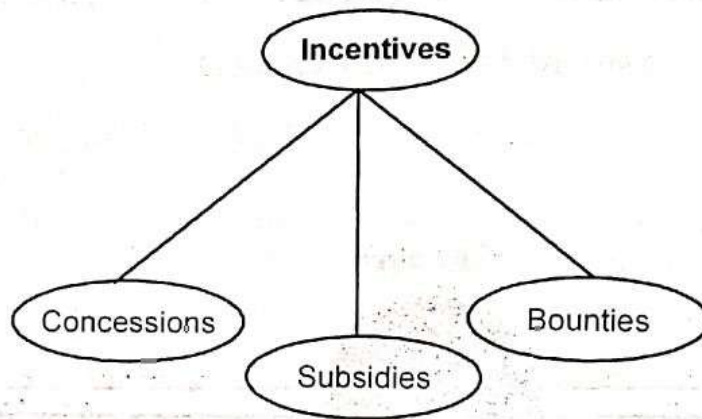


Fig. 37.1: Pattern of Incentives

'Subsidy' denotes a single lump sum which is given by a government to an entrepreneur to cover the cost. The term 'bounty' denotes a bonus or financial aid which is given to industry to help it to compete with other units in the country or in a foreign market. The objective of incentives is to motivate an entrepreneur to set up a new venture in the larger interest of the nation and the society.

### Controversies on the Efficacy of Incentives and Subsidies

Often one comes across an intellectual controversy over the good or evil or nil effect of incentive programmes. According to one criticism, the argument proceeds, of course, with empirical evidence and other pure measurement approaches, that incentive schemes would ultimately deteriorate into useless tax give-aways, would only cause other states to reciprocate with the result that industry locations would be affected by those lures and would cause the financial position of the exchequer seriously impaired. While this argument may be true, the industrial development schemes have been with us for more than three decades. As against this view, there are studies establishing the economic significance of the impact of incentive programmes. We also find, to our surprise, the fast-growing literature on the reappraisal of the 'legitimacy' of the regional economic/industrial policy with incentive schemes.

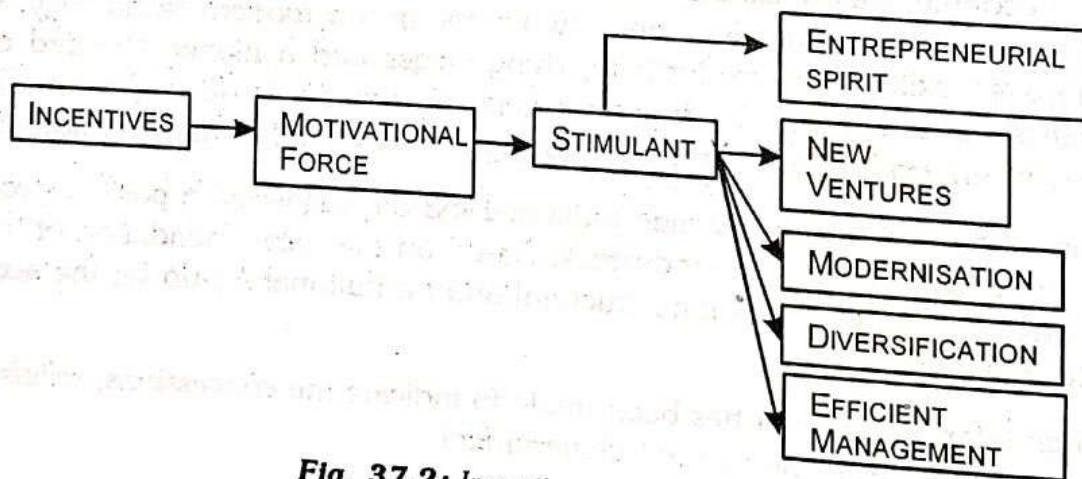


Fig. 37.2: Incentives as a Motivational Force

### Need for Incentives

The need for incentives and subsidies arises for the following reasons:

1. To correct regional imbalances in development: The usual package of incentives and concessions has been available in backward as well as developed districts. It has been, however, the experience of industrial administration, etc., that what is lacking in the backward districts is the

overall environmental growth. One of the ways is to identify pockets of savings of different activity groups like traders, businessmen, agriculturists, professionals, etc., and provide them with relevant information as well as suitable incentives to offset the disadvantages prevailing in such places. Industrial policy uses incentives both to correct the market imperfections and to accelerate the process of industrialisation so as to drive the forces of supply and demand reach the equilibrium level. Such a policy then aims at inducing some entrepreneurs or sections of the community (e.g., technicians) to locate their industrial units in areas selected by government rather than that of their own choice. Regional balances can also lead to effective utilisation of regional resources, removal of disparities in income and levels of living and contribute to a more integrated society.

2. To promote entrepreneurship by removing economic constraints: As for the economic constraints, the new entrants in the field face many impediments on account of inadequate infrastructures. The new entrepreneur suffers because of distances separating central administrative organs from entrepreneurs and their projects, deficiency of various supporting services such as market intelligence, entrepreneurial guidance, entrepreneurial training, technical consultancy and merchant banking facilities, lack of an institutional mechanism to provide full-time management personnel complementary to that of the new entrepreneurs, and finally from insufficient orientation of the promotional institutions, barring a few exceptions, at the State level to the needs of new entrepreneurs.

The various incentives normally aim at mitigating some or all the problems by several means. Industrial estates, industrial complexes, industrial nucleus, etc., availability of power, concessional finance, capital investment subsidy, transport subsidy, etc., are all but a few examples of incentives to solve the constraints impeding the emergence of entrepreneurs in industry.

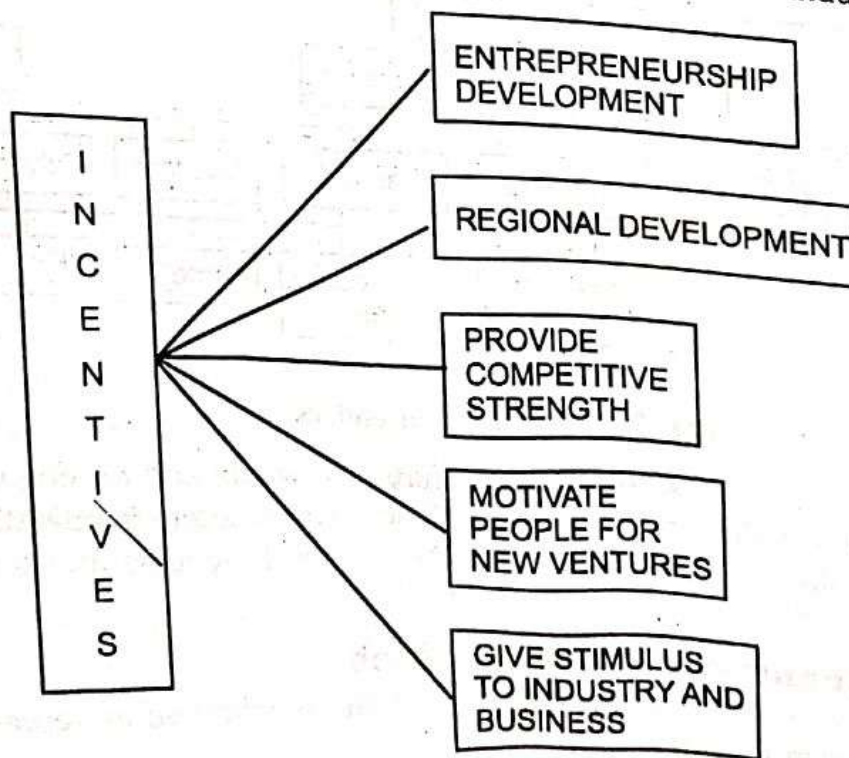


Fig. 37.3: Objectives of Incentives

3. To provide competitive strength, survival and growth: Some of the incentives are concerned with the establishment of industries while others are concerned with the survival and growth of industries. Several incentives are confined to the first few years of the establishment of the unit while a few of them are made available over a long period. Instances may be cited of the reservation policy



for small-scale industry due to which a small firm can hope to compete in the market to which entry by larger units is barred. If a small-scale unit is already established and is brought under the reservations policy later, it will be a case of incentive to support its competitive strength. For a newcomer, the reservation is an incentive to enter the industry itself. A price preference improves its competitive strength.

### The Assistance Programme

Some of the important measures of assistance now available for the entrepreneurs in the industrial sector are:

- (i) Technical assistance through industrial extension service;
- (ii) Assistance for obtaining raw materials;
- (iii) Cash assistance;
- (iv) Supply of machinery on hire-purchase basis;
- (v) Marketing assistance;
- (vi) Assistance to small entrepreneurs;
- (vii) Rural Industries Projects;
- (viii) Seed capital assistance;
- (ix) Concessional finance assistance;
- (x) Technology assistance;
- (xi) Pollution control.

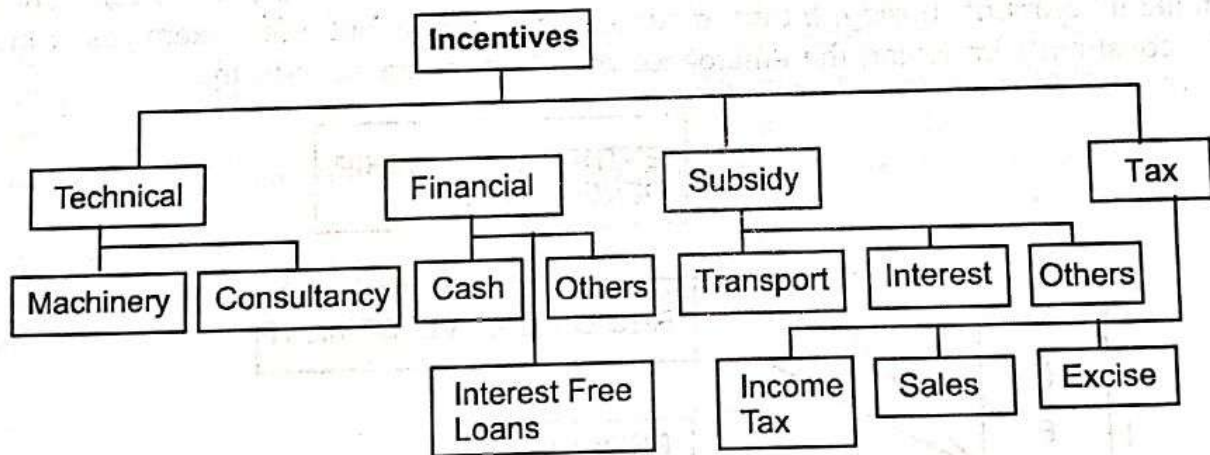


Fig. 37.4: Typess of Incentives

In order to promote industrialisation of the country as a whole and to remove disparities in levels of development between different regions, the Central Government is operating three major schemes, viz., central investment subsidy scheme, transport subsidy scheme and central assistance scheme for infrastructural development in no-industry districts.

### Advantages of Incentives and Subsidies

- (a) They act as a motivational force which makes the prospective entrepreneurs to enter into manufacturing line.
- (b) They encourage the entrepreneurs to start industries in backward areas.
- (c) By providing subsidies and incentives the government can –
  - (i) Bring industrial development uniformly in all regions.
  - (ii) Develop more new entrepreneurs which leads to entrepreneurial development.
  - (iii) increase the ability of entrepreneurs to face competition successfully.
  - (iv) Reduce the overall problems of small-scale entrepreneurs.

## Problems of Incentives and Subsidies

- Empirical studies reveal that the incentives and subsidies are being highly misused.
- Incentives and subsidies turned out to be grounds for dishonesty.
- They have given scope for favouritism and rampant corruption.
- They have become the seeds of unethical business practices.
- Resulted in financial drain on the exchequer.
- The real objective of providing incentives, subsidies and assistance is hardly achieved.

### Incentives Strategy

1. Subsidy for purchase of know-how	—	Varies from 50% to 100% of cost
2. Entrepreneur training	—	Free with stipend for SC/ST and women entrepreneurs
3. Developed Land	—	At subsidised cost, on hire-purchase/outright purchase basis
4. Factory shed	—	In industrial estates subject to availability
5. Machinery	—	On hire-purchase/lease
6. Seed capital loan (Margin Money Loan)	—	To start industries
7. Central Investment Subsidy	—	At the rate of 25% varies from ₹ 10 lakh to ₹ 50 lakh
8. State Investment Subsidy	—	10% to 15%
9. Tax Exemption	—	Excise and sales-tax exemption from stamp duty and concessional registration charges
10. Establishment Grant	—	In some cases
11. Stamp Duty	—	Exempted

Thus, a creative and shrewd entrepreneur can set-up a small-scale industry and/or industries without putting a single pie of his own and even capital out of it. Some successful entrepreneurs have built their own industrial empire, acquired status and power.

### Central Investment Subsidy Scheme

This was introduced in 1971, and has been modified from time-to-time. The scheme is for encouraging setting up of industries in centrally-notified backward areas. For setting up industries in Category A backward areas, subsidy is allowed at the rate of 25% subject to a maximum of ₹ 25 lakh (enhanced to ₹ 50 lakh for setting up electronics industry in hilly districts). It is 15% and 10% subject to a maximum of ₹ 15 lakh and ₹ 10 lakh for category 'B' and 'C' districts areas. Entrepreneurs who set up nucleus plants in Category 'B' and 'C' districts areas are eligible for 20% and 15% subsidy, subject to a maximum of ₹ 20 lakh and ₹ 15 lakh respectively. Since the inception of the Scheme and up to December 1989, a total sum of ₹ 855.46 crore has been reimbursed to States/Union Territories excluding Delhi and Chandigarh.

## Schemes of Incentives and Subsidies in Operation

Incentives in Operation	Subsidies in Operation
(i) Interest free loans,	(i) Export/Import subsidies and bounties,
(ii) Exemption from property tax,	(ii) Subsidy for R&D works,
(iii) Incentives to NRIs,	(iii) Capital investment subsidy,
(iv) Special incentives to women entrepreneurs,	(iv) Transport subsidy,
(v) Exemption from income-tax,	(v) Interest subsidy,
(vi) Interest-free sales tax loans,	(vi) Subsidy for power generations,
(vii) Sales tax exemptions,	(vii) Subsidies to artisans and traditional industries including handlooms,
(viii) Land and building at concessional rates,	(viii) Subsidy for buying test equipment,
(ix) Price preference to SSI Units,	(ix) Subsidy for industrial housing,
(x) Exemption from stamp duty,	(x) Subsidy/assistance for technical consultancy,
(xi) Provision of seed capital,	(xi) Subsidising the cost of market studies/feasibility studies or reports,
(xii) Allotment of developed/constructed sheds,	(xii) Subsidised consultancy services,
(xiii) Allotment of controlled or subsidised raw materials	(xiii) Subsidy for market studies,
(xiv) Concessional water	(xiv) Subsidy for quality standards,
(xv) Special facilities for import of raw materials	
(xvi) Taxation benefits	
(xvii) Excise concessions	

### Transport Subsidy Scheme

The scheme was introduced in 1971 and is applicable to hilly, remote and inaccessible areas. It covers the entire North Eastern Region including Sikkim, Jammu & Kashmir, Himachal Pradesh, hill districts of Uttar Pradesh, Lakshadweep and Andaman and Nicobar Islands and Darjeeling districts of West Bengal. Identified promotional institutions which transact business on behalf of small, village and cottage industries are also eligible for transport subsidy. Transport subsidy is paid on the transport costs of industrial raw materials which are brought into and finished goods which are taken out of these areas to identified rail heads/ports. In the North Eastern Region including Sikkim, Jammu and Kashmir, Lakshadweep, Andaman and Nicobar Islands, subsidy is available at the rate of 90% and for Himachal Pradesh, hill districts of Uttar Pradesh and Darjeeling district of West Bengal, it is 75%. It is also available at the rate of 50% for movement of raw materials within the North Eastern Region and at the rate of 50% for movement of finished goods within the North Eastern Region from one state to another state. For airlifting of electronic components/products from Calcutta airport to the airport nearest to the locations of the industrial units in North Eastern Region and Sikkim, subsidy is allowed at the rate of 75% and vice versa. Since the inception of the Scheme

in 1971 and up to December 1989, a sum of ₹ 45.80 crore (₹ 7.58 crore during the current financial year) has been reimbursed. The Scheme is in operation up to 31st March, 1990.

### **Central Assistance for Infrastructural Development in No-industry Districts under the Old Scheme**

To assist the State Governments in taking up infrastructural development in one or two identified growth centres in each No-industry District, the Central Government gives financial assistance which is limited to one-third of the total cost of infrastructural development, subject to a maximum of ₹ 2 crore per district. Two types of patterns have been laid down for the purpose:

#### **Pattern I**

₹ 2 crore as subsidy from the Central Government.

₹ 2 crore as share of the State Government. ₹ 2 crore as loan from IDBI on concessional terms.

#### **Pattern II**

₹ 2 crore as subsidy from the Central Government.

₹ 4 crore as share of the State Government.

₹ 5 crore as loan from IDBI on concessional terms after the shares of State and Centre are spent.

For States in the North Eastern Region, the Scheme has been further liberalised. In a total project of ₹ 4 crore, the Central Government's shares would be 50%, i.e., ₹ 2 crore per district and the State Governments have the option to fund the balance of ₹ 2 crore either from their own funds or by raising a loan from IDBI Construction of sheds, subject to a ceiling of 25% of the total cost, has been allowed in the case of North Eastern Region only.

So far 51 growth centres in 44 districts of the States of Rajasthan, Odisha, Uttar Pradesh, Karnataka, Madhya Pradesh, Bihar, Maharashtra, West Bengal, Tripura, Nagaland, Arunachal Pradesh and Mizoram have been approved by the government for development of infrastructural facilities. A sum of ₹ 15.42 crore has been released for creating infrastructural facilities in the States of Rajasthan, Odisha, Uttar Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Mizoram, Bihar and West Bengal till December 1988.

### **New Scheme for Growth Centres**

The government has announced on June 3, 1988, the decision to set up 100 growth centres throughout the country over the next five years or so. These growth centres, which would act as magnets for attracting industries to backward areas, would be endowed with infrastructural facilities on par with the best available in the country, particularly in respect of power, water, telecommunication and banking. Each growth centre would be provided with funds of the order of ₹ 25-30 crore in order to create infrastructural facilities of a high order.

In the first phase, it has been decided to take up 61 growth centres, allocated to various States/Union Territories as indicated below:

1.	Andhra Pradesh	4
2.	Assam	2
3.	Bihar	5
4.	Gujarat	2
5.	Haryana	2
6.	Jammu & Kashmir	2
7.	Karnataka	3
8.	Kerala	2
9.	Madhya Pradesh	5
10.	Maharashtra	4
11.	Odisha	3
12.	Punjab	2
13.	Rajasthan	4
14.	Tamil Nadu	3
15.	Uttar Pradesh	6
16.	West Bengal	3
17.	Arunachal Pradesh	1
18.	Goa	1
19.	Himachal Pradesh	1
20.	Manipur	1
21.	Meghalaya	1
22.	Mizoram	1
23.	Nagaland	1
24.	Pondicherry	1
25.	Tripura	1
<b>Total</b>		<b>61</b>

The States/Union Territories have been asked to identify double the number of growth centres allocated to them but the final selection of these will be done by the Central Government. The State Governments are also free to include any of the growth centres already approved under the erstwhile scheme for developing such centres in the 'No Industry Districts'.

The growth centres shall not be located within 50 kms of the boundary of 7 cities with a population of above 25 lakh, 30 kms from the boundary of 2 cities with a population of above 15 lakh but below 25 lakh and 15 kms from the boundary of 12 cities with a population of 7.5 lakh but below 15 lakh.

The growth centres shall be located close to District/Subdivisional/ Block/Taluk/Headquarters or developing urban centres.

The broad financing pattern for development of infrastructure in the selected growth centres will be as follows:

1.	Central Government (Equity)	₹ 10 crore
2.	State Government (Equity)	₹ 5 crore
3.	All India Financial Institutions (including ₹ 2 crore as equity)	₹ 4 crore

4.	Nationalised Banks	₹ 1 crore
		<hr/>
		₹ 20 crore
5.	Market borrowings	₹ 10 crore
		<hr/>
	<b>Total</b>	<b>₹ 30 crore</b>

The growth centres selected under this scheme will be included in Category 'B' (unless it is already included in Category 'A') of the list of Backward Areas and will be entitled to all incentives available from time-to-time for Category 'B' areas. The State Governments have been requested to make suitable provisions in their States/Union Territories Plan for 1989-90 for the development of these growth centres.

## Technology Policy

Over the years, a diversified and sophisticated industrial base has been built-up in the country along with technological skills and capabilities. The requirements of the industrial field are now vastly different from those in the early stages of industrialisation. The government's basic policy towards import of technology is aimed at reducing unnecessary dependence on external resources and achieving self-reliance through optimum utilisation of indigenous resources. It is, however, recognised by the government that it is equally necessary to update production technology continuously to keep pace with the rapid technological advances taking place in the developed countries. The import of technology is, therefore, selective, and is ordinarily permitted in high technology areas, in export-oriented or import substitution manufacture or for enabling indigenous industry to upgrade its existing technology to attain efficiency and competitive strength. Government has also laid emphasis on the need to ensure sufficient absorption and adaptation of the imported technology through adequate investment in research, engineering and development.

The objectives of the technology policy as embodied in the Statement issued in January 1983, are the development of indigenous technology and efficient absorption and adaptation of imported technology appropriate to national priorities and resources. It has been recognised that in-house Research and Development units in industry provide a desirable and essential interface between efforts within national laboratories as well as production in industry. Encouragement is, accordingly, given to individual units for setting up in-house R&D units with a view to absorbing, assimilating and adapting imported technology as well as development of advanced technology.

## Foreign Investment

Government's foreign investment policy is selective and is designed to channelise such investment into areas which require sophisticated technology, or where critical production gaps exist, or which would help increase the country's export potential. Foreign investment is regarded as a vehicle for transfer of technology that is needed by the country. The normal ceiling for foreign investment is 40% of the paid-up equity capital of the company, but a higher percentage of foreign equity may be considered in priority industries if the technology is sophisticated and closely held or if the venture is largely export-oriented. For wholly export-oriented units even 100% foreign equity can be considered. The foreign share capital should be contributed by way of cash and not by way of supply of machinery and equipment or remuneration for know-how and technical assistance. However, the Government of India, in 1980, relaxed the policy in respect of investors from the Oil Exporting Developing (OED) countries. Accordingly, investment up to 40% in the equity of new ventures without being linked with technology transfer can be made by investors from OED countries in specified industries. A second exception to the general policy is investment by non-residents of Indian origin who are allowed to invest in Indian industrial units under certain schemes and subject to certain conditions even if there is no transfer of technology along with the investment.

4.	Nationalised Banks	₹ 1 crore
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Payment for technology and know-how can be made either in the form of annual royalty or as lump sum payment or a mixture of both. The rate of royalty depends on the nature of technology and is normally limited to 5% for a period of 5 years. Where both lump sum and royalty payments are involved, the maximum payment is restricted to 8% of the net ex-factory value of production calculated for a period of 10 years. It has recently been decided that while the existing norms regarding royalty and lump sum payments should continue, these norms can be relaxed so that the existing ceiling on royalty/lump sum payments does not come in the way of obtaining sophisticated and closely held technologies.

### Technical Assistance

The industrial extension service, which is the most important item in the programme for the development of small industries, aims at providing complete technical, economic and managerial consultancy services to small-scale industries in order to upgrade the skills of workers, increase their productivity and wages, reduce the cost of production, improve the quality of the goods produced, and strengthen competitive position of the small units.

The industrial extension service is provided through the SSIs and Industrial Extension Centres located in different parts of the country. The SSIs are State-level agencies which render coordinated industrial extension services, while the Extension Centres are miniature institutes in the sense that their activities are limited to one or more specific industries and restricted to a smaller area. The Extension Centres, like the Small Industries Service Institutes, assist individual entrepreneurs to solve common technical problems, suggest improved designs and more up to date techniques of manufacture, train workers in improved techniques of production, management, marketing, etc., and serve as common service facilities centres. These services are now offered by 16 small industries services institutes, 5 branch institutes and 64 extension centres dispersed all over the country.

Broadly speaking, the industrial extension service provides technical assistance, economic service, and management consultancy services. The technical assistance includes:

- (a) Advice on improved technical process and the use of modern machines and equipment;
- (b) Preparation of drawings and machines and machine parts, equipment, dies, tools and fixtures;
- (c) Demonstration of the use of modern technical processes through workshops and mobile workshops mounted on trucks;
- (d) Research on proper use of equipment and improved designs of machinery;
- (e) Training classes in various technical trades like foundry, heat treatment, machine shop and blueprint reading for the benefit of small industrialists and artisans;
- (f) Assistance in the development of ancillary units;
- (g) Information which is made available to small industries on all technical matters.

Technical assistance is rendered in coordination with economic services and management consultancy services, and the whole programme has been widened to embrace all the small units. The quality of this programme, too, has been over the years.

Technical advice is rendered in various forms and includes: (i) on-the-spot advice in the factory to solve technical problems, and (ii) advice at Small Industries Service Institute's office on technical problems, including advice on when, how and where to start small industries.

### Obtaining Raw Materials

The raw materials required by small-scale units may be broadly classified as follows:

- (i) Raw materials, components and spare parts;
- (ii) Non-ferrous metals;
- (iii) Iron and steel,
- (iv) Chemical raw materials – indigenous and imported.



Under the liberalised scheme, the actual users are provided with adequate foreign exchange to meet their justifiable requirements, of imported items of industrial materials. The "priority" industries are assured of an adequate supply to the extent of their requirements by way of grant of rotational licences.

The small-scale units should apply directly to the Regional Licensing Authority concerned, and through the sponsoring authority, for import licences for raw materials, components, and spares after utilising their previous set of licences to the extent of 90 per cent by way of opening letters of credit or 60 per cent by way of actual imports, covering six months requirements of the unit.

The State Director of Industries allocates indigenous non-ferrous materials. Some of these non-ferrous items are canalised through the State Trading Corporation of India (STC), which offers imported raw materials to SSI units on the recommendation of the concerned Director of Industries.

Iron and steel raw materials are canalised through the MMTC on the recommendation of the Director of Industries.

In times of difficulties, the decontrolled chemical raw materials are canalised through DGTD on the recommendation of State Director of Industries, while indigenous controlled chemicals are allocated through the State DIs/SIs. Imported raw materials are canalised through the STC.

In short, controlled and imported raw materials have to be obtained through the State Director of Industries or the Development Commissioner, Small-scale Industries, New Delhi.

### **Supply of Machinery on Hire-purchases**

One of the major conclusions of the International Planning Team, 1953-54, was that deficiencies in small industries arose from the then prevailing methods of production and management, which fell short of the minimum efficiency requirements. The reluctance of small-scale units to instal modern and up to date machinery and equipment stemmed largely from the paucity of investible funds or fixed assets. It was against this background that the scheme for the supply of machinery on hire-purchase basis was formulated.

The National Small Industries Corporation has been rendering assistance to small-scale units by supplying machinery to them. Since its inception, the Corporation has supplied 57,946 machines on hire-purchase basis – 16,485 imported, 41,461 indigenous of the total value of ₹ 290.35 crore and has thus generated gainful employment for about 7.48 lakh workers and made possible an aggregate output worth ₹ 1,450 crore per annum. At the State level, the Small Industries Corporations provide indigenous machinery on deferred credit basis. The Chief Controller of Imports and Exports, New Delhi, issues import licences for machinery of foreign origin on the recommendation of the State Directors of Industries.

### **Marketing Assistance**

The problem of marketing constitutes one of the major problems of the small-scale industry. The absence of a market for their products had led to the sickness of many units, and some of them have had to close down. A large number of work with lower capacities, as a result of which they are not able to sustain themselves in a competitive market

The products of small-scale industries are generally marketed:

- (i) Directly to their parent body;
- (ii) In a free market or
- (iii) Through international channels.

With a view to promoting the growth of small-scale industries, the government has offered the following facilities to them:

- (i) Participation in Government's Stores Purchase Programme; and
- (ii) Trade Centres.

## Exports

Export promotion of products manufactured in the small-scale sector has been given considerable importance and efforts are being made to increase its share in total exports. The exports from the small-scale sector are estimated to have increased to ₹ 4,535 crore during 1987-88 as against ₹ 3,617 crore during 1986-87. The share of small-scale sector in the total exports during 1987-88 was 28.81 per cent. The Small Industries Development Organisation along with its field offices continued to provide techno-managerial assistance and guidance for the development and promotion of exports of small industry products. Training programmes in export marketing, packaging for exports, and workshops/seminars on various aspects of export development in the small-scale sector were organised in collaboration with other organisations. Efforts are continued to coordinate the activities of various organisations engaged in the promotion of exports with a view to increasing the share of small-scale sector in exports. Activities relating to dissemination of information on foreign markets and export opportunities are also undertaken.

## Assistance to Small Entrepreneurs

The development of entrepreneurial skill is the main plank of the strategy for the promotion of small-scale industries. A special programme, known as "Training of Young Engineers", was initiated in 1970-71. Under this programme, about 5,000 engineers were trained by the Small Industries Services Institute and a few non-government institutions. Of these, about one-third have already set up their own units. Another programme, known as "Assistance to Educated Unemployed", was launched in 1971-72, under which assistance of various kinds was made available for training, seed money, subsidy on interest on loans, machinery on hire-purchase basis and assistance for setting up industrial estates.

In order to locate prospective entrepreneurs and to assist them in setting up viable industrial units in the shortest possible time, intensive campaigns are launched by the Small Industries Development Organisation in close cooperation with promotional agencies. During the past decade, about 250 intensive campaigns were undertaken mostly in the backward pockets of the country.

The Small Industries Board constituted a Standing Committee on Entrepreneurial Development in 1974 to coordinate and review the programme of entrepreneurial development in the small-scale sector and to devise a well-organised programme for promoting entrepreneurship in small industries, particularly in backward areas.

As a result of a major shift in the government's policy, there has been a progressive reservation of items for exclusive manufacture in the small-scale industries sector, subject to the criteria of technical feasibility and economic viability, with a view to safeguarding this sector against undue competition from large-scale industries. The number of items reserved for the small-scale sector has increased from 45 in 1968 to 241 in 1977 and further to 836 in 2001.

With a view to encouraging the participation of small entrepreneurs in the Government's Store Purchase Programme, it was decided that preference should be given to them in order to ensure that their capacity is utilised to the fullest extent. The number of items reserved exclusively for purchase from the small sector increased progressively from 122 in 1968-69 to 409 in 1988-89. The value of orders placed by DGS&D and other government departments correspondingly increased from ₹ 30.50 crore in 1968-69 to ₹ 762 crore in 1988-89.

During the previous decade, the government had progressively liberalised its import policy and simplified import procedures to the advantage of small industrial units. The salient features of the import policy during the Fourth and Fifth Plans were – licensing of requirements of small industrial units under priority/selected sectors based on their actual needs; grant of higher value of initial licences to new engineering, chemical and electronics units; and grant of preferred sources of supply to units falling in priority/selected sectors, units selected in backward areas or set up by engineers, technocrats or ex-servicemen, etc.

In view of the persistent demand from small industrial units, and the increase in the value of machinery, the government decided to revise the definition of a small-scale unit and raised the upper limit of investment from ₹ 7.5 lakh to ₹ 60 lakh in the case of small industrial units, and from ₹ 10 lakh to ₹ 75 lakh in respect of small ancillary units supplying parts and components to large units.

### **Excise Concessions**

The Small-scale Exemption Scheme providing concessions to small-scale industries was modified during the year. The eligibility limit of ₹ 1.5 crore was raised to ₹ 2 crore, while the full exemption available to small-scale units up to ₹ 30 lakh in case where they manufacture more than one item falling under different "tariff headings".

A special incentive in the form of full MODVAT credit was allowed to the manufacture of final products on purchases of inputs from the small-scale units which had paid excise duty at concessional rates (vide paragraph 5 of Department of Revenue Notification dated 1.3.86). This concession was withdrawn w.e.f. 1.9.87 but subsequently restored till 31.3.90 by the Department of Revenue at a reduced rate and has been limited to a maximum of 5% *ad valorem*.

### **Price Preference for Small-scale Sector**

The price preference scheme for small-scale and public sector units reintroduced by the Union Government in 1980 is sought to be amended to drop the discretion that this should be implemented on "merits".

The condition that price preference should be given "on merit" gave rise to the question as to what "merit" is.

The Ministry of Supply and Rehabilitation sought the approval of the Union Cabinet that the current scheme of 15 per cent price preference on merit be amended to empower it to apply the scheme at a flat 15 per cent.

The Ministry proposes to extend the reservation scheme at present applicable to small-scale units to cover cottage, handicrafts and handloom units for exclusive government purchases.

Because of the condition that the 15 per cent purchase preference may be given "on merit", the Ministry has been doing it on a selective basis and going strictly by the efficiency of a unit.

According to the calculations of the Ministry, if the scheme is exempted to cover all the Small-scale units, an additional burden of ₹ 12 crore will fall on the exchequer.

In a note, the Ministry has stated that the policy of price preference for public sector undertakings should be clarified. While the Department of Supplies invites quotations, it has to give a 10 per cent price preference to public sector undertakings. Similarly, a 15 per cent preference has to be given to small-scale units.

There are no clear directives as how to calculate the price preference formula – whether the prices quoted by the large-scale units should be the basis for preference treatment for the small-scale and public sectors or whether the price quotations of public sector undertakings and small-scale units should be taken as the basis. In the absence of any clear directive in this regard, different interpretations have been given to the existing scheme, sometimes to the detriment of small units.

The Department of Supplies is also engaged in identifying the areas in small, cottage and handicrafts industries which may be exclusively reserved for government purchases.

According to authoritative sources, these may include candle-making units and match boxes which are made only in the cottage industries sector.

### **Comprehensive Programme to Promote Growth**

The main thrust of the development programme for small industries is to enable them to reach the maximum levels of efficiency through integrated assistance, which includes increased availability of technical services and facilities, management counselling and training, assistance to exports, etc.

**Chart 2**  
**Export Promotion – Export or Perish**

I. Institutional Organisations	II. Export Policy	III. Facilities for Exports	IV. Quality Control and Pre-shipment Inspection	V. Re-organisation and Re-orientation of Trading Practices
<ol style="list-style-type: none"> <li>1. Export Promotion Councils</li> <li>2. Commodity Boards</li> <li>3. Board of Trade</li> <li>4. Advisory Councils of Trade</li> <li>5. Trade Development Authority</li> <li>6. Zonal Export Advisory Committee</li> <li>7. Chambers of Commerce and Associations of Trade and Industry,</li> <li>9. Federation of Indian Export Organisations</li> <li>10. Export Processing Zone</li> <li>11. Indian Institute of Foreign Trade</li> <li>12. Export Inspection Council</li> <li>13. STC</li> <li>14. Indian Council of Arbitration</li> <li>15. Trade Representatives and Commissioners</li> <li>16. Commercial Intelligence Services</li> <li>17. Indian Standards Institution</li> </ol>	<ol style="list-style-type: none"> <li>1. Export Control Relaxation</li> <li>2. Export Duty Reduction</li> <li>3. Excise Duty Reduction</li> <li>4. Import Duty Reduction</li> <li>5. Tax Relief to Exporters</li> <li>6. Cash Compensatory Allowance</li> <li>7. Import Licence for Raw Materials and Equipment Import</li> <li>8. Devaluation</li> </ol>	<ol style="list-style-type: none"> <li>1. Bilateral Trade Agreements</li> <li>2. General Agreement of Tariffs and Trade</li> <li>3. Trade Delegations</li> <li>4. Trade Fairs and Exhibitions</li> <li>5. Transport Concession</li> <li>6. Liberal Export Credit</li> <li>7. Export Credit Insurance</li> <li>8. Show Rooms Abroad</li> </ol>	<p>We must have compulsory Quality Control Marketing and Quality Control and Issue of Certificate of Quality after Pre-shipment Inspection</p>	<ol style="list-style-type: none"> <li>1. Standardisation</li> <li>2. Simplification of Procedure</li> <li>3. Mediation and Settlement of Disputes</li> </ol>

The Small Industries Development Organisation (SIDO), with its network of nearly 100 Small Industries Service Institutes, Branch Institutes, Extension Centres, provides a wide range of such services.

With the ever-growing requirements of the small entrepreneurs, the SIDO has increased its technical services. During the previous decade, more than 1,25,000 design drawings and blueprints were supplied to entrepreneurs along with about 5,000 model schemes, plant guides, project guides and impact schemes. The popularity of the technical services provided by the SIDO is evident from the fact that the number of entrepreneurs seeking guidance from it increased from 57,000 in 1965-66 to 4,30,000 in 1988-89. On an average, Technical Officers visited about 70,000 units annually to provide on-the-spot guidance. The work-shop facilities provided by the SIDO were also widely utilised by entrepreneurs.

In order to cater to the new requirements of the rapidly growing and diversified small industries sector, the SIDO took effective steps to streamline and retool its technical services. These included modernisation of the workshops attached to the Small Industries Service Institutes by the addition of new machines and sophisticated services, the setting up of four regional testing centres, and the launching of a special programme for the modernisation of selected industries. The programme, which aims at developing the competitive strength of small industries, envisages the provision of such necessary inputs as machinery, finance, raw materials, training, and techno-managerial assistance to selected industries on a priority basis.

With a view to assisting a large number of entrepreneurs, artisans, technocrats and other investors to select new items for production or expand existing industrial units, detailed economic information is supplied on the basis of industry-wise and area-wise surveys conducted by the SIDO. On an average, about 80,000 small entrepreneurs annually avail themselves of these services. A Data Bank has been set up in the headquarters of the SIDO. Consultancy services in management development and training have been provided by the SIDO to enable small-scale units to solve their problems of marketing, export promotion, cost reduction, inventory control and personnel administration.

The Small Industries Extension Training Institute (SIETI) widened and increased the area of its operations and conducted training courses in various aspects of management development, financial management, marketing, ancillary development and area development. The institute also organised special tailor-made courses for participants from several developing countries.

In 1968-69, two new institutes were set up with UNDP assistance to expedite the modernisation of mechanical and electrical industries. These are the Central Institute of Tool Design (CITD) and the Institute for the Design of Electrical Measuring Instruments (IDEMI). Since 1969-70, the CITD has been conducting two regular courses in machine tools, dies and moulds for engineers and for technicians. In 1977 it organised seven advanced training courses and provided toolroom services to 800 small units, besides technical consultancy services to 1,500 entrepreneurs. During the last five years, the IDEMI has developed 780 tools and prototypes and imparted training to 350 engineers in different areas of instrument engineering and technology.

The SIDO has maintained close liaison with ministries and other organisations with a view to getting the maximum allocation of imported and indigenous raw materials for the small-scale sector. In order to ensure an adequate supply of scarce raw materials and determine the exact requirements of certain groups of industries using indigenous and scarce raw materials, the SIDO has started assessing the capacity of industrial units on a scientific basis.

## **Technical Development Fund Scheme**

In order to promote technological upgradation and modernisation, the Ministry of Industry has been operating a Technical Development Fund Scheme since 1976. After a review of the Scheme,

government liberalised the scheme in 1988 to make it more flexible and result-oriented. Satisfied with the utilisation of the TDF Scheme, the Scheme was further liberalised in 1989. It is being administered by a Special Committee led by the Ministry of Industry and acts as a single window clearance agency to allow composite import packages consisting of capital goods, technical know-how, technical assistance, technical drawings and designs and consultancy services, etc.

The ceiling for import under this Scheme has been raised to foreign exchange equivalent to ₹ 3 crore per unit per financial year from the earlier limit of ₹ 2 crore. This limit is further relaxable to enable a costlier technology package to be implemented without fragmentation in deserving cases. For applicants who are exporting more than 10% of the total turnover of the company or more than 25% of the production of the particular item for which the TDF approval is sought, this limit is relaxable by 50%, subject to appropriate guarantees to be furnished by the applicants for the fulfilment of export commitment. There is no limit on the number of applications that an applicant unit can submit under the Scheme, provided the aggregate value is within the TDF ceiling.

An industrial unit is entitled to avail of TDF facilities if it has commenced commercial production prior to the date of application. The Scheme has been made available for taking up the manufacture of any item included in the broad-banded group in the licence/registration held by the applicant industrial unit.

The earlier limit of 49% on capacity expansion has been raised in the case of non-MRTP and non-FERA companies including MRTP, registered under Section 20 (b) in respect of the product in which they are not dominant. The Scheme can be suitably relaxed to enable those sick industrial units who have reported to BIFR in terms of SICA to implement their modernisation/cost-reduction schemes by taking up forward/backward integration or other suitable measures to recover their financial health.

With a view to maintaining fast track disposal, powers have been delegated to JS (SIA) to dispose of small value cases (less than ₹ 10 lakh) on file.

## **Import of Capital Goods for Select Priority Industries**

With a view to exposing engineering industries to international competition and recognising the need for reducing the cost of investment in industries of national priority, a new facility was introduced in the Import Policy since 1978-79, under which select industries are allowed to invite global tenders for meeting their capital goods requirement. The proposals in this regard are considered by an empowered Committee, under the Chairmanship of Secretary, Department of Industrial Development. While taking a decision on the selection of suppliers, comparison between Indian offers and foreign offers on the basis of landed cost of the latter is given due weightage. Successful Indian suppliers are permitted to import raw materials and components freely. Such exposure to international competition is expected to introduce technological upgradation among these industries and also make them cost-effective. The industries covered under this procedure are:

Fertilisers, newsprint and paper, basic drugs, basic technical material for pesticides and weedicides, power generation, transmission and distribution, mineral exploration, mining and beneficiation, petroleum exploration and production of petro-chemicals up to the stage of polymers, manufacture of professional grade electronic components, waste disposal recycling and affluent treatment projects and ecological engineering, material-handling projects at ports, sugar and cement products (including asbestos).

During the period from January 1989 to December 1989, four requests for permission for floating global tenders were received and considered by the Committee. Out of these four, three cases have been approved by the Empowered Committee and one case has been rejected as it was felt that there was no need for floating global tenders.

## Expanding Horizon

The scope of the small industries programme of the government has been expanding rapidly during the last decade. Many new schemes have been undertaken to speed up the growth of the small-scale sector in recent years.

As a supporting programme, the National Small Industries Corporation helps small-scale units to get supplies of up to date plant and machinery on hire-purchase basis. As many as 30,000 modern machines, worth ₹ 80 crore, have so far been supplied to nearly 15,000 units. A salient feature of the scheme is that both indigenous and imported machinery is supplied on easy instalments. On a conservative estimate, the hire-purchase scheme is responsible for the creation of installed capacity capable of producing goods worth over ₹ 600 crore and the employment of about 4 lakh persons.

## Conclusion

The concessions, reliefs and incentives offered by the Central Government in India cover a wide spectrum of activities of small-scale industries from technology, capital to marketing and training. In the present context of liberalisation and globalization of the economy, the small-scale sector should take advantage of already existing factor endowments and raise the levels of their economies to a higher level of development, and growth. The need of the hour is to integrate the existing concessions and reliefs to small-scale industry and provide a real impetus to the sustained growth of the small-scale sector on an ongoing basis. The foremost task is that the government's role should be catalyst in the process of development of small-scale industries. Towards this end, the government should embark upon creating the right environment for the small-scale industry.

## ANNEXURE-1

### FACILITIES AND INCENTIVES TO SMALL-SCALE INDUSTRIES

LAND	States develop industrial areas with infrastructure facilities and allot, sell or lease on a no-profit-no-loss basis with 10 per cent to 12 per cent down payment and the balance in instalments at low rates of interest.
INVESTMENT SUBSIDY	Investment subsidy, ranging between 10 per cent to 15 per cent, subject to a ceiling is granted to industries to be set in backward and tribal areas.
INTEREST SUBSIDY	Interest subsidy at different rates is granted to industrial units set up by educated self-employed, technocrats, engineers, craftsmen and artisans, subject to the capital investment not exceeding the limit set by the different states.
POWER TARIFF	A subsidy on electricity tariff for a period of 3 to 5 years is granted according to use and on certain terms and conditions. This is made available for certain types of units whose power constitutes a major item of production cost. The type of product produced is also taken into consideration while granting this subsidy.
FINANCIAL ASSISTANCE	States grant financial assistance by way of (interest) loans, sales-tax loans and loans from State Financial Corporations. The amount of

assistance varies according to the type of industry and is given against immovable property and personal security. Assistance to artisans and craftsmen ranges between ₹ 3,000 to ₹ 5,000 and for others between ₹ 10,000 and ₹ 25,000 at an interest ranging between 7.5 per cent and 13.5 per cent. The repayment period is between 5 and 10 years or more. The grant of financial assistance depends on the type of industry, products produced and on merit.

**TECHNICAL ASSISTANCE**

The State's Directorate of Industries and the Industries Department provide technical guidance for the setting up and erection of machinery and also for expansion. All possible technical assistance is given to new entrepreneurs.

**FEASIBILITY STUDY**

For industries having definite prospects, State Governments, through their own agencies conduct feasibility studies free of cost up to ₹ 1,000 or grant 50 per cent to 75 per cent subsidy for the preparation of feasibility reports. This cost is converted into the share capital of the government.

**PRICE PREFERENCE**

State Government and Local Boards give a price preference of 15 per cent to 20 per cent over the prices offered for the products of large and medium industries in all government purchases and on products for a certain period provided the quality is on par with that of similar products of bigger units.

**OTHERS**

Octroi is exempted on capital equipment and raw materials for different periods for industries. Property tax is exempted for new industries for a certain period. Subsidy on transport cost and supply of water on a no-profit no-loss basis. Housing schemes get 50 per cent loan and 25 per cent subsidy. Royalties on raw materials to government considered on merit on an economic basis. Assistance to educated unemployed, engineers, technically qualified persons, etc., to set up own units.

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# CONCESSIONS AND RELIEFS BY STATE GOVERNMENTS

## Introduction

Among the important factors relating to industrial locations, state incentives also play a key role. Although central incentives and subsidies assist the growth of enterprises in the country, it is the state incentives which attract entrepreneurs to set-up their enterprises in a particular State/Union Territories. The objectives of state incentives is to provide assistance and facilities to allure and motivate techno-entrepreneurs, intreprenuers and first generation entrepreneurs to locate their ventures in their region. State incentives must be so devised as to synchronise private incentives with social returns in an efficient, cost-effective manner that simultaneously promote moral imperatives. To the extent state incentives are a tool, no less than a programme, they make industrialisation and growth of entrepreneurship a reality. The nature of assistance, however, varies from state-to-state.

## Maharashtra a Premier Industrial State - A Model

State incentives aim at alluring maximum entrepreneurs to accelerate the process of economic development in the state, and also shift the composition of industrial growth away from highly capital-intensive sectors towards more labour-intensive sectors.

Maharashtra is a premier industrial state and as such, the details of state incentives as in operation in Maharashtra are discussed in this chapter.

### Objectives of state incentives and subsidies

1. To attract entrepreneurs to set up their projects in the state.
2. To assist in the dispersal of industries.
3. To make investment in industrially backward areas more remunerative.
4. To help the entrepreneurs to overcome certain disadvantages in setting up industries, and
5. To speed up the process of industrialisation.

## State Aid to Industries Act

Under this Act, entrepreneurs in the State of Maharashtra are eligible to get financial help in the form of loans, guarantees for loans and subscriptions to shares and debentures, etc. Loans up to the value of ₹ 1,000 is provided on personal bonds. Any loan up to the value of ₹ 5,000 is provided against two personal sureties. Loans exceeding ₹ 5,000 are provided against security of movable and immovable assets. Loans can be repaid over a period of 10 years by way of easy instalments. The State Director of Industries can also help the entrepreneurs in getting accommodation in industrial estates and other related assistance in the form of water, power, raw materials, etc.

## Directorate of Industries

The State Directors of Industries provide several types of assistance and facilities to entrepreneurs. They furnish information about the assistance available to industries from the State Government. Directorate of Industries makes available the following assistance to entrepreneurs:

- (i) Supply of raw materials, electric power and transport facilities.
- (ii) Requirements of land for setting up small-scale industry plants.
- (iii) Cash loans under the State Aid to Industries Act repayable in 10 years
- (iv) Provision of accommodation in their industrial estates.
- (v) Training facilities.
- (vi) Supply of information on the organisation of cooperatives.
- (vii) Grant of essentiality certificates for import licences, raw materials, components, etc.

## Major Task of the Policy

Steering the industries outside the congested Bombay-Thane-Pune belt to the underdeveloped and developing areas of the State has been a major task for the policymakers in the government. It was, therefore, thought necessary to offer fiscal and monetary incentives, which would help the entrepreneurs setting up these areas, overcome certain disadvantages in doing so. To achieve this end, the State Government has been implementing a package of incentives since 1964.

In designing the package of incentives under the Scheme, steps have been taken to make investment in industrially backward areas more remunerative and attractive by prescribing higher scales of incentives in proportion to fixed capital investment of the units depending upon their location. Based on the experience gained in the implementation of this Scheme, amendments have been made from time-to-time.

## Package Scheme of Incentives 1988

In the following pages the latest Scheme titled "Package Scheme of Incentives 1988" introduced from 1<sup>st</sup> October, 1988 for a period of five years till 30th September, 2003 is given.

An attempt has been made here to simplify and provide only the broad outlines of the Scheme for general information. However, the provisions contained in the Government Resolution, Industries, Energy and Labour Department No. IDL 1088/(6603)/IND-8 dated the 30th September, 1988 shall be treated as final and binding.

## Coverage Under the Scheme

The following industries will be covered under the 1988 Scheme:

- (i) Industries listed in the first schedule for the Industries (Development and Regulation) Act, 1951, as amended from time-to-time.

- (ii) Industries falling within the purview of the following Boards/Agencies:
- (a) Small-scale Industries Board.
  - (b) Coir Board.
  - (c) Silk Board.
  - (d) All India Handicrafts Board.
  - (e) All India Handloom Board.
  - (f) Khadi and Village Industries Board.
  - (g) Any other Agency constituted by Government for industrial development.
- (iii) (a) Poultry and agro-industries (Capital expenditure on land, building and equipment alone will be eligible).
- (b) Mining.
  - (c) Cold storage.
  - (d) Hotel (subject to guidelines of the Government of India as applicable from time-to-time).
  - (e) Service industries of the type of general workshops including repair workshops (No other service industries are eligible for subsidy).
  - (f) Dry cleaning by mechanical process.
  - (g) Data processing.

Incentives under the 1998 Scheme will be available to eligible units in the private sector, state public sector/joint sector and the cooperative sector.

Eligible units under the state public sector and joint sector will be entitled to incentives only under Part I of the 1988 Scheme and not Part II.

Central public sector undertakings will not be considered eligible for incentives under the 1998 Scheme.

The following industries are not eligible under the 1988 Scheme:

- (i) Charcoal.
- (ii) Saw Mill.
- (iii) Edible and non-edible oil or manufacture of any oil by means of processes such as crushing, solvent extraction, refining, hydrogenation, etc.

## Classification of Areas

For the purpose of the 1988 Scheme, the areas in the State have been classified into five groups A, B, C, D and No Industry District as detailed in Annexure II. Developed areas are covered under Group 'A', where no incentives are available. Depending on the industrial backwardness of the area concerned, the incentives offered in other areas are on a graded scale, a minimum amount of incentives being available in Group 'B' and maximum amount available in the No Industry District.

## Definitions

(1) *Existing Unit*: An industrial unit set up by any entity in the private sector, cooperative sector or state public sector/joint sector in any taluka, which satisfies any one of the following conditions:

- (a) The unit is in production on or any time prior to September 30, 1988, for any period whatsoever;
- (b) The unit is granted a Letter of Intent/Eligibility Certificate or the unit has availed of any incentives under any of the earlier Schemes;

- (c) The unit has filed a valid application for grant of Eligibility Certificate under the 1983 Scheme with any of the implementing agencies on or before September 30, 1988, after completion of all the initial effective steps.

(2) *Export-oriented Unit*: An eligible unit which is set up for the manufacture of goods, with an obligation to export not less than 50 per cent of the annual output, will be considered an export-oriented unit.

(3) *New Unit*: An industrial unit which is set up for the first time by an entity in the private sector, cooperative sector or state public sector/joint sector in any taluka where there is no existing unit set up by the said entity provided that the unit satisfies the following further conditions:

- (a) At least one of the final effective steps is completed on or after October 1, 1988 for setting up the unit;
- (b) It is not an existing unit;
- (c) It is not formed as a result of re-establishment, mere change of ownership, change in the constitution, reconstruction or revival of an existing unit.

(4) *Pioneer Unit*: A large-scale new unit set up after October 1, 1988 or large-scale fixed capital investment made by an existing unit after October 1, 1988 in Group 'C' or Group 'D' areas for which at least one final effective step is taken after October 1, 1988, will be considered eligible for pioneer status if it satisfies any one of the following conditions:

- (i) It is a new unit with fixed capital investment exceeding ₹ 5 crore in Group 'C' area, or ₹ 2 crore in Group 'D' area, being set up as the first unit in point of time in a taluka where, there is, as on October 1, 1988 no existing unit with a net fixed capital investment of the said order, namely, ₹ 5 crore in Group 'C' area, or ₹ 2 crore in Group 'D' area. Under this category, only one unit in taluka will be considered eligible for pioneer status.
- (ii) It is a new unit with fixed capital investment exceeding ₹ 25 crore being set up in Group 'C' or Group 'D' areas.
- (iii) It is an expansion/diversification undertaken by the existing/new unit in either Group 'C' or Group 'D' area as an adjunct to the existing/new unit or otherwise in the same taluka involving additional fixed capital investment made thereunder after October 1, 1988 in excess of ₹ 25 crore.

Under the categories (ii) and/or (iii) above, any number of units in a taluka will be considered eligible for pioneer status.

(5) *Power-intensive Unit*: An eligible unit which consumes energy constituting 25% or more of the total cost of production, will be classified as a power-intensive industrial unit.

(6) *Expansion/Diversification*: An existing/new unit in any of the areas covered under Group 'B' Group 'C', Group 'D' or No Industry District which created on or after October 1, 1988, additional fixed capital investment for additional production/manufacturing facilities for the manufacture of the same product/products as of the existing/new unit (expansion) or different products (diversification) in the same taluka where the existing/new unit is located, will be considered eligible for incentives under the 1988 Scheme as an expansion/diversification only if it satisfies the following conditions:

- (a) Such expansion/diversification should provide for additional fixed capital investment by medium-scale industrial (MSI) unit/large-scale industrial (LSI) unit exceeding ₹ 1 crore or by small-scale industrial (SSI) unit exceeding ₹ 25 lakh by way of additions to the production/manufacturing facilities;
- (b) The said additional fixed capital investment should exceed 25 per cent of the gross fixed capital investment of the existing/new unit immediately prior to the setting up of the additional production facilities;

- (c) In the case of expansion or expansion-cum-diversification but not mere diversification per se, the said additional fixed capital investment should result in an increase in the existing installed capacity by at least 25 per cent; and
- (d) Such expansion/diversification should increase employment in the nonsupervisory category at least to the extent of 10 per cent of the pre-expansion/diversification level of such employment and 80 per cent of such additional employment should be out of local population.

(7) *Fixed Assets*: The term "Fixed Assets" covers all the assets of the eligible unit as erected at the site and includes:

- (a) Land;
- (b) Building – any built-up area used for the eligible unit, including administrative building, residential quarters, industrial housing and all such facilities provided in the building as are required for the manufacturing process;
- (c) Plant and machinery – tools and equipment, including handling and haulage equipment or tools as are necessarily required and exclusively used for sustaining the working of the eligible unit;
- (d) The cost of development of the environment of the location of the eligible unit such as fencing, construction of roads and other infrastructural facilities which the eligible unit has to incur under the project;
- (e) Technical know-how, including the cost of drawings, know-how and the fees.

## Incentives

Broadly, the incentives available under the 1988 Package Scheme are classified as follows:

- (A) Under Part I:
  - (i) Special Capital Incentive
  - (ii) Sales Tax Exemption/Deferral
  - (iii) Sales Tax Incentives as an interest-free unsecured loan under certain specified circumstances
- (B) Under Part II — Sales Tax Deferral only
- (C) Incentives for Expansion/Diversification:
  - (i) Special Capital Incentive
  - (ii) Sales Tax Incentive as an interest-free unsecured loan under certain specified circumstances
- (D) Refund of Electricity Duty
- (E) Refund of Octroi
- (F) Preferential treatment in the purchase programmes of Government/Government Undertakings/Statutory Bodies
- (G) Contribution towards cost of feasibility study
- (H) Additional incentives on credit points.

It may be noted that Part I and Part II Schemes of Incentives are mutually exclusive and no unit would be eligible to get both the incentives simultaneously.

The option once exercised shall be final and binding on the unit.

*Deferment Period*: The period for which the sales tax liability will be deferred under Part I and Part II will be 10 years from the date of availment and shall be repayable thereafter in five equal annual instalments.

The details of the above incentives are given below:

### Incentives Under Part I

(i) *Special Capital Incentive*: For new and/or new pioneer units. A new unit or a new pioneer unit set up on or after 1st October, 1988 will be entitled to special capital incentive at the rate indicated in the table below:

Eligible unit in Area	Quantum (Percentage) of Fixed Capital Investment		Ceiling (₹ in lakh)	
	MSI/LSI	SSI	MSI/LSI	SSI
Group 'B'	20%	25%	20	10
Group 'C'	25%	30%	25	15
Group 'D'				
No Industry District	30%	35%	30	20
Pioneer Unit	30%	—	30	—

**Note:** Special Capital Incentive will be admissible as a grant and the eligible unit will be entitled to draw the incentives after completion of both initial and final effective steps and the same will be computed on the basis of fixed capital investment actually made by the eligible unit. The quantum of special capital incentive will be available in addition to the amount of central subsidy wherever applicable. Special Capital Incentive will be not admissible to, (i) pioneer units which acquire pioneer status, by virtue of expansion/diversification entailing additional fixed capital investment exceeding ₹ 25 crore in the same taluka, and: (ii) eligible units opting for sales-tax incentive under Part II.

(ii) *Sales Tax Exemption/Deferral*: The sales tax incentives under Part I of the 1988 Scheme will be admissible to new units/pioneer units and their quantum would be as given in the table below:

Eligible unit in Area	For MSI/LSI Ceiling as Percentage of the Fixed Capital Investment	For SSI Ceiling as Percentage of the Fixed Capital Investment	No. of years as under or earlier if ceilings are reached
Group 'B'	60	100	
Group 'C'	75	100	5
Group 'D'	90	100	7
Pioneer Unit	95	100	9
No Industry District		—	10
	100	100	10

The eligible unit covered under this scheme shall exercise the option to avail of admissible incentives either in the form of exemption or deferral before the issue of eligibility certificate. The option so exercised shall not be permitted to be changed except once during the eligibility period. The effect of such change during the eligibility period shall be available for the unexpired period and up to the unavailed ceiling of such eligibility certificate issued to the eligible unit from the period beginning with the accounting year immediately following the date of grant of permission for such change of option.

(iii) *Sales Tax Incentive as an Interest-free Unsecured Loan in certain specified circumstances:* In respect of the eligible unit under the 1988 Scheme, undertaking manufacturing activities which are legally not considered "manufacturing activities" under the Sales Tax Law, as for instance, dyeing/texturising/processing of yarn/basic products of iron and steel in different forms, etc., the sales tax incentives will be allowed as an interest-free unsecured loan rating above equity repayable after 10 years in five equal annual instalments in lieu of exemption/deferral. The quantum admissible in such cases will be subject to the ceiling specified in (ii) above. The incentive will be worked out on the basis of the amount of sales tax payable and paid on the purchase of raw materials and sales tax/turnover tax/additional tax payable and paid on sales of finished products of the eligible unit. The eligible unit will prefer the claim with the respective implementing agency every year within six months from the date prescribed for filing of the returns for the last quarter/month of the accounting year followed by the eligible unit.

## Incentives Under Part II

*Sales Tax Deferral:* An existing units should fulfil the following conditions for claiming eligibility under Part II, for setting up a new unit/expansion:

- (i) The existing unit has for the three years immediately prior to the year in which the application for eligibility certificate is filed, paid in respect of the products in Maharashtra, sales tax in excess of ₹ 15 lakh (if the existing unit is located in Group 'A' area) or ₹ 5 lakh (if the existing unit is located in Group 'B', Group 'C' and Group 'D' areas or No Industry District).

AND

- (ii) The unit has not opted for Part I.

The eligible unit, under Part II, will be entitled to sales tax incentive as per the quantum indicated below, whichever is less:

For the purpose of incentives, the existing unit may choose any block of 3/4/5 or 6 consecutive years, as the case may be, from the years 1991-92. The block so chosen shall not, however, include any year for which the existing unit has availed of sales tax incentive under Part II, of any of the earlier schemes. The sales tax liability shall not include the sales tax liability of any unit set up by the existing unit which has already availed of incentives under any of the earlier Schemes.

Eligible unit in Area	Quantum of fixed capital investment in the new unit	Quantum limited to sales tax paid by the existing unit during the following period	Ceiling
Group B and Export-orient units	25%	3 years	₹ 50 lakh
Group 'C'	30%	4 years	₹ 75 lakh
Group 'D'	35%	5 years	₹ 100 lakh
Pioneer Unit or No Industry District	40%	6 years	₹ 150 lakh

## Option to Eligible Unit Under the Earlier Schemes

The benefit of deferral of sales tax under Part II will also be admissible to eligible units under Part II of the earlier Schemes at their option. The said benefit will, however, be restricted to the balance amount of sales tax loan covered by their respective eligibility certificates after excluding the amount, if any, already availed of as interest-free loan.

### Expansion/Diversification

Incentives for units eligible under expansion/diversification would be available as under:

#### (a) Special Capital Incentives

Eligible Unit in Area	Quantum (Percentage of Fixed Capital Investment)		Ceiling (₹ in lakh)	
	MSI/LSI	SSI	MSI/LSI	SSI
Group 'B'	15	20	20.00	20.00
Group 'C'	20	25	25.00	20.00
Group 'D'	25	35	25.00	20.00
Pioneer Unit	25	—	25.00	—
No Industry District	25	35	25.00	20.00

#### (b) Sales Tax Incentives by Way of Exemption/Deferral

Eligible Unit in Area	For MSI/LSI	For SSI	No. of years as under or earlier if Ceilings are reached
	Ceiling as Percentage of the Fixed Capital Investment	Ceiling as Percentage of the Fixed Capital Investment	
Group 'B'	50	85	4
Group 'C'	60	85	6
Group 'D'	70	85	8
Pioneer Unit	80	—	9
No Industry District	85	90%	9

### Other Incentives

**Refund of Electricity Duty:** The incentive shall be admissible in the form of Refund of Electricity Duty to New Power Intensive Industrial Units/Power Intensive Pioneer Units which are set up in Group 'B', Group 'C', Group 'D' or No Industry District areas. This refund will be admissible for a period of 3/5/7 years for 'B' 'C', 'D', Pioneer Unit and No Industry District respectively without any monetary ceiling. The period shall commence from the date of effect of the eligibility certificate. This refund shall be in the form of a grant.

**Refund of Octroi:** Only new unit/expansion/diversification/pioneer unit covered under Definitions in 4(i) and (ii) eligible under Part I or II will be entitled to refund of octroi duty payable and paid to the local authority on import of all the items required by the eligible unit. The same will be admissible in the form of a grant.



The incentive will be available for the period as indicated below:

Area and Period	For units eligible wider Part I	For units eligible under Part II
Group 'B' units - 5 years	From the date of commencement of commercial production	During implementation of the project till commencement of commercial production
Group 'C' units - 7 years	-do-	-do-
Group 'D' units - 9 years	-do-	-do-
Pioneer Units - 10 years	-do-	-do-
No Industry District - 10 years	-do-	-do-

**Note:** The incentive will be admissible only after the Eligible Unit goes into commercial production. The Octroi Incentive shall be restricted up to 100% of the admissible fixed capital investment of eligible unit.

### Preferential Treatment in the Purchase Programmes of the Government/Government Undertakings/Statutory Bodies

In order to give preferential treatment to the eligible units under the 1988 Scheme to whom necessary eligibility certificates have been issued by the implementing agencies, the State Government and specified State Government Undertakings and Statutory Bodies shall purchase from such eligible and quoting units, thirty-three per cent of the intended quantity at the lowest acceptable price in the open competitive tenders.

The period for which the incentive will be available shall be as follows:

Group 'B' Area	Group 'C' Area	Group D' Area	Pioneer Unit No Industry District
3 years	5 years	7 Years	9 years

from the date of commencement of commercial production.

### Contribution Towards Cost of Feasibility Study

The implementing agency may give 75% contribution towards the cost of preparation of a feasibility study either undertaken by the said implementing agency or done through an agency approved by it. If the project is implemented, the contribution shall be treated as an unsecured loan for a period of five years from the date of disbursement. The loan shall bear interest at such rate as may be prescribed by the implementing agency. If the project is not implemented within the prescribed time, the feasibility study shall become the implementing agency's property.

### Additional Incentives

Additional incentives shall be available to the eligible units for a period of additional one year and up to additional 10% of fixed capital investment, separately for the following credit points, viz., energy saving devices, installation of effluent treatment plants/measures and employment of local persons, as detailed below:

- (i) **Energy Saving Devices:** The admissibility in this regard would be determined by the government in consultation with the Energy Department.

- (ii) *Installation of Effluent Treatment Plant/Measures:* The incentive shall be admissible for those eligible units who abide by the stipulations of the Pollution Control Board/ Environmental Department of the government and adherence to these stipulations shall be monitored through these agencies. The admissibility in this regard would be determined by the government in consultation with the Environment Department.
- (iii) *Employment of Local Persons:* The incentive shall be admissible to the eligible units who employ a minimum of 80 per cent local persons in the non-supervisory category and 50 per cent local persons in supervisory category and maintain these levels throughout the period of eligibility certificate.

## Effective Steps

For the purpose of the 1988 Scheme, effective steps will comprise initial effective steps and final effective steps.

### (1) The Initial Effective Steps

- (i) The unit shall be in effective possession of land. If the land is outside the Maharashtra Industrial Development Corporation Area/Government-sponsored and/or financially-assisted Cooperative Industrial Estate/Mini-industrial Estate, the permission to convert the same to non-agricultural use should have been obtained. The possession of land will be considered effective only from the date of such permission and not before.
- (ii) In the case of a Partnership Firm or a Company or a Cooperative Society or a Trust, the registration of the Firm or Company or Society or Trust should have been obtained. The initial effective step regarding the registration of firm should be deemed to have been completed if the firm submits to the implementing agency documentary evidence in support of the execution of a partnership deed and files application with the payment of the necessary fees for registration to the Registrar of Firms.
- (iii) The unit should have obtained provisional SSI Registration or Letter of Intent from the Government of India and/or permission from the State Government for setting up/shifting of the unit, if such permission is required to be obtained. In the case of the unit covered by the Khadi and Village Industries Board (KVIB) Programme, the unit should have obtained registration from the KVIB.
- (iv) In the case of a medium/large-scale unit not covered under the licensing provisions of the Industries (Development and Regulation) Act, 1951, the unit should have applied for Directorate General of Technical Development (DGTD) Registration or Registration from the concerned technical authorities in respect of industries covered by special regulations or from the Secretariat for Industrial Approvals (SIA).

### (2) The Final Effective Steps

- (i) Industrial licence/necessary clearance under Foreign Exchange Regulation Act (FERA) and Monopolies and Restrictive Trade Practices Act (MRTP) or DGTD Registration or Registration from the concerned technical authorities in respect of the industries covered under the special regulations or from the SIA should have been obtained.
- (ii) Capital goods (CG) Clearance/Import Licence, wherever necessary, should have been obtained.
- (iii) The means of finance for the project should have been completed to the satisfaction of the implementing agency concerned.
- (iv) Other clearances, if any, from the Central/State Government and/or other authorities concerned with implementing the project should have been obtained.

- (v) The unit should have acquired at site fixed assets to the extent of at least 10 per cent of total fixed assets as envisaged for the project.
- (vi) The unit should have incurred expenditure on the project, including advances paid and pre-operative expenses to the extent of at least 25 per cent of the capital cost envisaged for the project.

For the purpose of incentives under Part I as well as Part II to a pioneer unit where the project is proposed to be implemented in suitable phases and the first phase of the project itself involves gross fixed capital investment exceeding ₹ 5 crore the final effective steps will be deemed to have been completed if the final effective steps for the first phase of the project are completed to the satisfaction of the implementing agency.

The unit satisfying conditions of the 1988 Scheme should submit an application for eligibility in the prescribed form to the appropriate implementing agency only after completing all the initial effective steps. Such an application should be filed on or before September 30, 1993. Units which file such applications after completing the initial effective steps are permitted to complete the final effective steps before September 30, 1994 for the purpose of eligibility.

## General

*Option for Sales Tax Incentives:* A one-time option shall be provided to the eligible units to avail of the special capital incentive in the form of additional sales-tax incentives instead of cash grant at twice the monetary ceiling of the special capital incentive admissible to the eligible unit and additional period of 1, 2 and 3 years for SSI and 1, 2 and 3 years for MSI/LSI for Group 'B', Group 'C' and Group 'D' areas respectively shall be available for such sales-tax incentive in lieu of special capital incentive.

*Option for Electronic Scheme 1987 or the 1988 Scheme:* An eligible unit may opt for incentives either under the Maharashtra Incentive Scheme for Electronic Industry, 1987 outlined in the Government Resolution, Industries, Energy and Labour Department, No. IDL. 1085/(5313)/IND/8, dated 29th July, 1987 or under the 1988 Scheme.

The option once exercised shall be final and binding on the eligible unit and it shall not be allowed to change the option so exercised after issue of the eligibility certificate.

*Sales Tax Coverage:* For the purpose of exemption from payment of tax liability the following taxes will be covered:

- (i) Purchase Tax/Sales Tax under the Bombay Sales Tax Act, 1959 on the purchase of raw materials and sales of finished products of the eligible unit.
- (ii) Central Sales Tax payable under the Central Sales Tax Act, 1956 on the sale of finished products of the eligible unit effected in the course of inter-state trade or commerce.
- (iii) Turnover Tax/Additional Tax payable under the Bombay Sales Tax Act, 1959.

For the purpose of deferment of payment of sales tax liability, the following taxes will be covered:

The Bombay Sales Tax Act, 1959/Bombay Sales Tax Rules, 1959/Central Sales Tax Act, 1956. The Central Sales Tax (Registration and Turnover) Rules, 1957/The Central Sales Tax (Bombay) Rules, 1957 and the conditions/stipulations in the Certificate of Entitlement issued by the Commissioner of Sales Tax.

## Implementing Agencies

The State Industrial and Investment Corporation of Maharashtra Limited (SICOM) shall implement the 1988 Scheme in respect of medium and large-scale units.

The Regional Development Corporations (RDCs) shall implement the 1988 Scheme as indicated below in respect of small-scale units coming within their respective jurisdiction, as also those graduating from small to medium-scale if an eligibility certificate has been issued earlier to the SSI unit by the concerned RDC.

	Name of the RDC	Jurisdiction (Districts)
(1)	Development Corporation of Konkan Ltd., (DCK)	Raigad, Ratnagiri, Sindhudurg and Thane.
(2)	Development Corporation of Vidarbha Ltd., (DCVL)	Akola, Amravati, Bhandara, Buidhana, Chandrapur, Gadchiroli, Nagpur, Wardha and Yavatmal.
(3)	Marathwada Development Corporation Limited (MDC)	Aurangabad, Beed, Jalna, Latur, Nanded, Osmanabad and Parbhani.
(4)	Western Maharashtra Development Corporation Ltd., (WMDC)	Ahmednagar, Dhule, Jalgaon, Kolhapur, Nashik, Pune, Sangli, Satara and Solapur.

All the eligible units shall comply with the requirements preceding the issue of eligibility certificate by the implementing agency so as to ensure obtaining the eligibility certificate within a period of six months from the date of commencement of commercial production as laid down in the procedural rules.

**Claim for Incentive:** No right or claim for any incentives under the 1988 Scheme shall be deemed to have been conferred by the 1988 Scheme merely by virtue of the fact that the unit has fulfilled on its part the conditions of the 1988 Scheme. The incentives under the 1988 Scheme cannot be claimed unless a Letter of Intent/Eligibility Certificate has been issued under the 1988 Scheme by the implementing agency concerned and the eligible unit has complied with the stipulations/conditions of the Letter of Intent/Eligibility Certificate.

The Bihar state has announced a 20-point programme of assistance to accelerate the process of entrepreneurship in Bihar. They are:

## Initiating a Project

### 1. Feasibility/Project Report Subsidies:

(a) given @ 1% (limited to ₹ 50,000) on investment up to ₹ 1 crore and @ 1/2% (max. ₹ 3 lakh) on investment above one crore. 75% of the subsidy is released when the term loan is sanctioned and the balance on completion of the project.

(b) New/existing units in small/medium sector who are not eligible for Energy Audit Subsidy Scheme of All India Financial Institutions, can avail of a subsidy @ 25% (subject to max. of ₹ 25,000) for cost of preparation of Energy Audit Report and Plan of Energy Conservation.

### 2. Financial Assistance:

Financial assistance by way of equity participation up to 10-15 per cent for assisted sector units and 26 per cent or more (but not exceeding 51% of the equity) in case of joint sector unit are given by the Corporation. The Corporation also provides guarantee of term loan and help in arranging financial supports from State level/Central level financial institutions and Banks.

3. *Technical know-how:*

Technical know-how fee is subsidised up to 90% (max. ₹ 40,000) for SC/ST/Technical entrepreneurs/first generation entrepreneurs and for 'A' category districts.

4. *Capital Investment Subsidies (CIS):*

(a) Although the Central Capital Investment subsidy has been discontinued w.e.f. 31.12.89, the State Govt. as per policy resolution effective for 5 years with effect from 01.01.90 has decided to continue the Capital investment subsidy to all new units set-up in all districts in the State @ 15% (max. ₹ 15 lakh). This facility is also available for expansion programme of existing units if the capacity is raised by at least 50% of the existing installed capacity.

(b) Additional 5% (limited to ₹ 5 lakh) capital investment subsidy will be available to units located in Notified Growth Centres, units promoted by NRI and 100% Export-oriented Units.

(c) Additional 10% (limited to ₹ 10 lakh) is available for investment on Energy Saving Schemes based on Energy Audit Report or otherwise for small and medium sector units.

5. *Infrastructural Facilities:*

All other infrastructural facilities such as allotment of land/shed, provision of power connection, telephone/telex, etc., are given on priority on liberalised terms.

6. *Subsidy on Diesel/Kerosene Generating Sets:*

Given @ 20% (subject to a maximum of ₹ 5 lakh) to large and medium projects for purchase and installation of captive generating sets.

7. *Exemption of Electricity Duty:*

All electricity duty payments are exempt up to 25% (maximum up to ₹ 1 lakh per annum) from 1st September, 1990 for a period of 5 years.

8. *Power Subsidy:*

Power costs are also subsidised to the extent of 9 paise per unit for large-scale industry and 12 paise per unit for medium-scale units with effect from 1st September, 1990 for a period of 5 years.

9. *Water Rate Subsidy:*

Water is supplied at cost to industries using water from sources maintained by the government.

## Getting into Full Swing

10. *Manufacturing Assistance:*

This includes assistance in all aspects of production management and control as diverse as stores and purchase as per price preference Rules and online quality control. This is available to all units including sick and closed units seeking rehabilitation and small-scale units expanding to medium-scale.

11. *Marketing Assistance:*

Necessary steps are taken to expedite payments to industries selling to government departments and organisations.

## Easing the Tax Burden

12. *Interest-free Sales Tax Loan/Sales Tax Relief:*

Sales tax relief on purchases of raw materials for 5 years and interest free sales tax loan up to ₹ 30 lakh for 'A' category districts and up to ₹ 20 lakh for other districts are provided. Repayment of the ST loan starts from the 6th year and is realised in 5 equal annual instalments.

## Managing Transitions

### 13. Rehabilitation Subsidies:

These include all concessions, reliefs and incentives made available by the State Government for revival and rehabilitation of closed and sick industrial units.

### 14. Development Incentives:

These include all incentives offered by the State Government to units seeking to expand and diversify:

### 15. Facilities for 100% Export-oriented Units:

Units classified as such by the Government of India have sanctions and disbursement of assistance, land, and power connections expedited on a priority basis.

### 16. Facilities for Electronics Units:

From September 1, 1990 all such units have sales tax exempted for a period of five years. Technical support services are also provided to small and medium-scale units.

### 17. Facilities for Non-resident Indians (NRI/OCB):

NRI/OCB are given topmost priority on all matters of incentives/facilities including allocation of developed land/factory shed/power connection/telephone connection/telex, etc.

## Expediting the Procedures

### 18. Effective Monitoring Assistance:

State and district level committees meet periodically to take the measures necessary to facilitate and speed up the procedures for setting up new industrial ventures and to ensure their smooth running.

## Exploring the Future

### 19. Miscellaneous Initiatives:

BSIDC has several programmes in hand under consideration for directly and indirectly providing help and opportunities for industrial enterprise.

(i) *Data Bank and Management Training Institute:* A modern data bank hooked to NIC's national computer network for improved decision support and an institute to train local entrepreneurs in management skills and disciplines.

(ii) *Growth Centres:* These are being developed by the State Government with assistance from the Government of India and IDBI in no-industry districts to make them suitable for industry and thus foster balanced industrial growth in the State.

(iii) *Science and Technology Entrepreneurs Parks:* This is a special complex being set up at Ranchi for the development of industries based on high technology.

(iv) *Electronics Estates:* Two industrial estates are projected exclusively for electronics with provisions of raw materials bank.

(v) *Quality Assurance:* 25% (subject to a max. of ₹ 6,000) on investment made on testing equipment and 50% of the expenditure in getting ISI certification is reimbursed by the State Government.

### 20. Incentives for Expansion/Diversification:

All the aforesaid incentives/facilities/subsidies are also available for expansion/diversification of existing industrial units.

## Conclusion

Besides Central Government incentives and subsidies, the State Governments too offer fiscal and monetary incentives and subsidies to help entrepreneurs setting up their industries in the states to overcome certain disadvantages. The entrepreneurs are attracted to some states for their package of incentives, subsidies. The foremost incentive is a stable government with excellent law and order situation followed by availability of disciplined, dedicated and skilled labour force. However, states do attract industries by giving incentives in regard to sales tax, octroi, and subsidised loan. The state incentives have helped in large measure in attracting entrepreneurs to set-up industries and accelerate the process of industrialisation. State incentives and subsidies have helped entrepreneurs to locate their projects and industrialise the state on a firm foundation. The innovations of state incentives and subsidies indicate their adaptivity and the vital role they have been playing in the process of industrial development, spanning rural and urban, backward and non-backward, organised and unorganised, large, medium and small sectors of the economy – each sector needing different approaches, strategies, skills and techniques.

### ANNEXURE-1

#### Major Incentives and Concessions to SSI Units in Selected States

Gujarat	Category I Areas	Category II Areas
1. Capital Investment Subsidy Tiny Industries	35% of eligible fixed capital investment	25% of eligible fixed capital investment
Small-scale Industries	30% of eligible fixed capital investment with a maximum of ₹ 30 lakh	20% of eligible fixed capital investment with a maximum of ₹ 20 lakh
2. Sales Tax Incentives Tiny Industries Small-scale Industries	100% of eligible fixed capital investment for 9 years	100% of eligible fixed capital investment for 6 years
3. Additional Sales Tax Benefits	Available to employment-oriented units	
4. Sales Tax Benefits for 100% EOUs	100% of fixed capital investment for 10 years	75% of fixed capital investment for 8 years
5. Other Incentives: to 100% EOUs	Priority allotment of land and raw materials.	

**Maharashtra**

- |    |   |      |   |
|----|---|------|---|
| 1. | Sales Tax incentive to new SSI units as Exemption/Deferral/Interest free unsecured loan.  | B    | 100% of Fixed Capital Investment for 6 years                |
|    |   | C    | 110% of Fixed Capital Investment for 8 years                |
|    |   | D    | 120% of Fixed Capital Investment for 10 years               |
|    |   | D +  | 130% of Fixed Capital Investment for 12 years               |
| 2. | Special capital incentive for SSI units only.   | B    | 15% of Fixed Capital Investment with a maximum of ₹ 7 lakh  |
|    |   | C    | 20% of Fixed Capital Investment with a maximum of ₹ 10 lakh |
|    |   | D    | 25% of Fixed Capital Investment with a maximum of ₹ 15 lakh |
|    |   | D +  | 30% of Fixed Capital Investment with a maximum of ₹ 20 lakh |
| 3. | Refund of Octroi/Entry Tax in the form of a grant up to 100% of the admissible. Fixed Capital Investment to New SSI units.  | B    | for a period of 5 years                                     |
|    |   | C    | for a period of 7 years                                     |
|    |   | D    | for a period of 9 years                                     |
|    |   | D +  | for a period of 12 years                                    |
| 4. | (a) Refund of electricity duty to new SSI units.<br>(b) Refund of electricity duty to new units in Electronic Hardware Technology Parks (EHTPs) and to 100% EOUs. | D    | Grant for a period of 7 years                               |
|    |   | D +  | Grant for a period of 10 years                              |
|    |   | (A)  | Grant for a   |
|    |   | (B)  | period of   |
|    |   | (C)  | 5 years   |
|    |   | (D)  | Grant for a period of                                       |
|    |   | (D+) | 7 years   |

Note: Taluka in the State have been classified as A, B, C, D and D+ in the order of most to least developed areas.

**Kerala**

- |        |  |   |
|--------|--|---|
| 1.     | Investment subsidy for thrust industries (electronics, rubber, processing, food processing, light engineering, drugs and pharmaceuticals, leather, clay and silica based industries and garment manufacturing industries). | 15% of Fixed Capital Investment subject to a maximum of ₹ 20 lakh. Also available to existing units undertaking expansion, diversification and modernisation. |
| 2. (a) | Sales Tax exemption/deferment to all new industrial units and existing units undertaking expansion, diversification and modernisation.   | Exemption for 7 years/deferment for 10 years up to a ceiling of 100% of fixed Capital Investment.   |
| (b)    | Additional option of SSIs only.  | To deposit the Sales Tax with the Government in the 'Tax for Growth Fund'.  |



3. Concessions to ensure a market for products manufactured by SSI units in the State.
4. Exemption from electricity duty and enhancement in power tariff.

A price preference of 15% for all departmental purchases, purchases made by State public sector enterprises and statutory corporations.  
To all new units for the first five years.

### Tamil Nadu

1. State Capital Subsidy in most backward talukas and other specified areas
2. Special Subsidy for select category of industry
  - (a) To encourage priority and sunrise industries.
  - (b) For leader and electronic units.
3. Concessions in power tariff for three years for all units (except located in metropolitan areas)
4. Generator subsidy for certain industries
5. Liberalised Sales Tax waiver/ deferral scheme up to a ceiling of total investment in fixed assets
  - (a) Full waiver for five years
  - (b) Deferral for 9 years
  - (c) Deferral for 5 years up to a maximum of 60%
6. Subsidies and concessions to women entrepreneurs
  - (a) For units where women constitute more than 30% of the work-force
  - (b) Reservation in the allotment of industrial sheds and developed plots.

20% of fixed assets with a ceiling of ₹ 20 lakh

15% of fixed assets with a ceiling of ₹ 15 lakh

A sum not exceeding ₹ 15 lakh based on 10% of cost of fixed assets ₹ 20 lakh, and ₹ 35 lakh respectively

1<sup>st</sup> year 40% of energy charges

2<sup>nd</sup> year 30%

3<sup>rd</sup> year 20%

15% of the cost of narrator subject to a maximum of ₹ 5 lakh

New and existing units located in most backward talukas

New units located in 82 backward talukas and in government developed industrial areas.

New industries in other areas

5% additional capital subsidy up to a maximum of ₹ 5 lakh

30% reservation in all new Industrial Estates and Industrial Complexes developed by Government organisations.

**West Bengal**

- |   |  |
|---|--|
| <p>1. One-time subsidy on Investment in Plant and Machinery<br/>                 (a) Valued up to ₹ 2 lakh<br/>                 (b) Valued above ₹ 2 lakh</p> | <p>40% for industries in B, C and D category and for specified industries in A category districts<br/>                 15% for industries in A and B category districts, 20% in C and 30% in D category districts<br/>                 20% in B, C and D category districts only</p> |
| <p>2. One-time subsidy on cost of drawing power line and installation of transformer</p>  | <p>25% irrespective of the location provided such cost is not borne by the Power Supply Agency</p>   |
| <p>3. One-time subsidy on cost of purchase and installation of Gen. Sets</p>  | <p>100% for a period of 5 years in B, C and D category districts only<br/>                 100% for a period of 3 years in B, C and D category districts only</p>  |
| <p>4. Waiver of Electricity duty w.e.f. the date of commencement of activities</p>  | <p>100% for 5 years for A, B and C category and 9 years for D category districts</p>   |
| <p>5. Exemption from payment of Octroi/Entry Tax w.e.f. the date of commencement of activities</p>  | <p>100% for 4 years in A (specific industries only) and B category districts and 6 and 8 years</p>   |
| <p>6. Exemption of Sales Tax on purchase of Raw Material<br/>                 (a) for new SSI units<br/>                 (b) for expansion/modernisation</p>  | <p>100% for 5 years for A, B and C category and 9 years for D category districts<br/>                 100% for 4 years in A (specific industries only) and B category districts and 6 and 8 years</p>  |

- 
- Notes: (i) The incentives are available for new SSI units as well as for units undertaking expansion/modernisation.  
 (ii) Districts in the State have been classified as A, B, C and D in the order of most to least developed areas.



# Meaning of Accounting

The present age is the age of trade, business and commerce. After Globalization, liberalization and privatization, business is increasing day by day and becoming complex also. An organization can't remember all its dealing for long.

Therefore, it becomes necessary to keep written record of all business transactions day by day, this leads to the development of accounting.

Luca Pacioli is considered to be the father of modern bookkeeping. The only recording of financial transaction in bookkeeping is not enough to achieve the commercial objective, but also it is important to know the financial result.

It is necessary that the recorded transaction is collected, classified and summarized. This work is done by accounting. After identifying the financial transaction, through the basic accounting process, they are recorded properly in a systematic manner in the books. The meaning of accounting can be made clearer by understanding its process and components.

## Process of Accounting:

Accounting is the systematic application of identifying, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial

information. It reveals profit or loss for a given period and the value and the nature of a firm's assets and liabilities and owners' equity.

In other words, accounting is a practice and body of knowledge concerned primarily with

→ Method for recording transactions

→ Keeping a financial record

→ performing internal audit

→ Reporting and analyzing financial information to the management and

→ Advising on taxation matters

### Definitions of Accounting

Some prominent definitions of accounting to help us better understand the meaning of basic accounting.

→ According to Committee of Terminology of American Institute of Certified Public Accountants, "Accounting is the art of recording, classifying, summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of a financial character and interpreting the results thereof".

→ According to Bierman and Drebin: "Accounting may be ~~the~~ defined as identifying, measuring, recording and communicating financial information".

Therefore, accounting can be defined as "the process of recording, summarizing, reporting and analyzing required financial information relating to the economic events of an organization".

the economic events of an organization to the interested users for making decisions."

## Components of Basic Accounting:

### 1. Recording:

The primary function of accounting is to make records of all transactions that the firm enters into. For the purpose of recording, accountant maintains a set of books. Their procedures are very systematic. Now-a-days, the computer has been deployed to automatically account for transactions as they happen.

### 2. Summarizing:

Recording of transaction creates a raw data. Sentences of road 8000 of little used to in organization for decision-making. Pages and pages of raw data are of little use to an organization for decision-making. For this reason, the accountant classifies data into categories.

### 3. Reporting:

Management is answerable to the investors about the company's state of affairs. The operations that are being financed with the money of owners, it needs to be periodically updated to them. For this reason, there are periodic reports annually summarizing the performance

of all ~~the~~ four quarters are sent to them.

In the form of financial statements reporting is done. To ensure that there is no misleading financial reporting, these financial statements are also regulated by government bodies.

#### 4. Analyzing.

Lastly, accounting entails conducting an analysis of the result. After results have been summarized and reported, meaningful conclusion needs to be drawn. Management must find out its positive and negative points. Accounting helps in doing so by means of comparison. It is common factors to compare profit, cash, sales and assets etc. with each other to analyze the performance of the business.

Thus, accounting is a language of business. It communicates the performance of business with various end users who are interested to know about the business. Accounting provides quantitative information of financial nature to both management and other users so that they can take a proper decision about business.

## Accounting is a Science

Accounting has its own principles, rules and techniques. On the basis of these principles, of transactions recorded systematically in order to know the results of a business. That's why it is regarded as a science.

## Accounting is an Art

Every businessman records a business transaction in the books of accounts as per rules, according to the nature of the business and determine the results after analyzing, so it's an art. Thus, it is clear from the above discussion that accounting has the elements of both art and science.

## Objectives of Accounting:

The following are the main objectives of accounting:

1. To maintain full and systematic records of business transactions.

Accounting is the language of business transactions. Given the limitations of human memory, the main objective of accounting is to maintain a full and systematic record of all business transactions.

## 2. To ascertain profit or loss of the business:

Business is run to earn profits. Whether the business earned profit or incurred loss is

ascertained by accounting by preparing Profit & Loss Account or Income statement. A comparison of income and expenditure gives either profit or loss.

### 3. To depict financial position of the business;

A businessman is also interested in ascertaining his financial position at the end of a given period. For this purpose, a position statement called Balance Sheet is prepared in which assets and liabilities are shown.

Just as a doctor will feel the pulse of his patient and know whether he is enjoying good health or not, in the same way by looking at the Balance Sheet, one will know the financial health of an enterprise. If the assets exceed liabilities, it is financially healthy i.e., solvent. In the other case, it would be insolvent, i.e., financially weak.

### 4. To provide accounting information to the interested parties;

Apart from the owner of the business enterprise, there are various parties who are interested in accounting information. These are bankers, creditors, tax authorities, prospective investors, researchers, etc. Hence, one of the objectives of accounting is to make the accounting information available to these interested parties to enable them to take sound & realistic decisions. The accounting information is made available to them in the form of annual report.