Small-Scale Industries in India: Definition, Characteristic and Objectives

In Indian economy small-scale and cottage industries occupy an important place, because of their employment potential and their contribution to total industrial output and exports. Government of India has taken a number of steps to promote them. However, with the recent measures, small-scale and cottage industries facing both internal competition as well as external competition. There is no clear distinction between small-scale and cottage industries. However it is generally believed that cottage industry is one which is carried on wholly or primarily with the help of the members of the family. As against this, small-scale industry employs hired labour. Moreover industries are generally associated with agriculture and provide subsidiary employment in rural areas. As against this, small scale units are mainly located in urban areas as separate establishments.

Definition: - The official definitions of a small scale unit are as follows:
(i) Small-Scale Industries: - These are the industrial undertakings having fixed investment in plant and machinery, whether held on ownership basis or lease basis or hire purchase basis not exceeding Rs. 1 crore.
(ii) Ancillary Industries: - These are industrial undertakings having fixed investment in plant and machinery not exceeding Rs. 1 crore engaged in or proposed to engage in, (a) The manufacture of parts, components, sub-assemblies, tooling or intermediaries, or (b) The rendering of services supplying 30 percent of their production or services as the case may be, to other units for production of other articles.
(iii) Tiny Units: - These refer to undertakings having fixed investment in plant and machinery not exceeding Rs. 23 lakhs. These also include undertakings providing services such as laundry, Xeroxing, repairs and maintenance of customer equipment and machinery, hatching and poultry etc. Located m towns with population less than 50,000.
(iv) Small-Scale Service Establishments: - These mean enterprises engaged in personal or household services in rural areas and town with population not exceeding 50000 and having fixed investment in plant and machinery not exceeding Rs. 25 lakhs.
(v) Household Industries: - These cover artisans skilled craftsman and technicians who can work in their own houses if their work requires less than 300 square feet space, less than 1 Kw power, less than 5 workers and no pollution is caused. Handicrafts, toys, dolls, small plastic and paper products electronic and electrical gadgets are some examples of these industries.

Characteristics of Small-Scale Industries:

(i) Ownership: Ownership of small scale unit is with one individual in sole-proprietorship or it can be with a few individuals in partnership.
(ii) Management and control: A small-scale unit is normally a one man show and even in case of partnership the activities are mainly carried out by the active partner and the rest are generally sleeping partners. These units are managed in a personalised fashion. The owner is activity involved in all the decisions concerning business.
(iii) Area of operation: The area of operation of small units is generally localised catering to the local or regional demand. The overall resources at the disposal of small scale units are limited and as a result of this, it is forced to confine its activities to the local level.
(iv) Technology: Small industries are fairly labour intensive with comparatively smaller capital investment than the larger units. Therefore, these units are more suited for economics where capital is scarce and there is abundant supply of labour.
(v) Gestation period: Gestation period is that period after which teething problems are over and return on investment starts. Gestation period of small scale unit is less as compared to large scale unit.
(vi) Flexibility: Small scale units as compared to large scale units are more change susceptible and highly reactive and responsive to socio-economic conditions. They are more flexible to adopt changes like new method of production, introduction of new products etc.
(vii) Resources: Small scale units use local or indigenous resources and as such can be located anywhere subject to the availability of these resources like labour and raw materials.
(viii) Dispersal of units: Small scale units use local resources and can be dispersed over a wide territory. The development of small scale units in rural and backward areas promotes more balanced regional development and can prevent the influx of job seekers from rural areas to cities.

Objectives of Small Scale Industries: The objectives of small scale industries are:

1. To create more employment opportunities with less investment.
2. To remove economic backwardness of rural and less developed regions of the economy.
3. To reduce regional imbalances.
4. To mobilise and ensure optimum utilisation of unexploited resources of the country.
5. To improve standard of living of people.
6. To ensure equitable distribution of income and wealth.
7. To solve unemployment problem.
8. To attain self-reliance.
9. To adopt latest technology aimed at producing better quality products at lower costs.

Definitions of Micro, Small & Medium Enterprises

1. Manufacturing Enterprises-he enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the industries (Development and regulation) Act, 1951 or employing plant and machinery in the process of value addition to the final product having a distinct name or character or use. The Manufacturing Enterprise are defined in terms of investment in Plant & Machinery.
2. Service Enterprises: The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment. The limit for investment in plant and machinery / equipment for manufacturing / service enterprises, as notified, vide S.O. 1642(E) dt. 29-09-2006 are as under

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<tr>
<th>Manufacturing Sector</th>
<th>Services Sector</th>
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<td>Enterprises</td>
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<td>Micro Enterprises</td>
<td>Does not exceed twenty five lakh rupees</td>
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<td>Service Sector</td>
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<td>More than two crore rupees but does not exceed five core rupees</td>
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### Differences between Cottage and Small Scale Industries

(i) The location of cottage industries is restricted in villages whereas the small scale industries are mostly located in urban and semi-urban areas.

(ii) Cottage industry being a household industry is mostly run by the members of the family and therefore do not maintain hired labourers. But the small industries are mostly run by hired labourers.

(iii) Cottage industries are producing goods for meeting local requirements whereas small industries are producing goods to meet the demand for the people living in a wider area.

(iv) Cottage industries are investing a very little amount of capital and are working with simple tools. But the small industries are investing a comparatively higher amount of capital (presently the limit has been raised from Rs. 60 lakh to Rs. 3 crore) and are working with machines run by power.

(v) Cottage industries are mostly located in the house of the artisans itself whereas the small scale industrial units are located in the industrial and business complex.

(vi) Cottage industries are being operated both as part time and full time occupation but the small scale industries are mostly operated as full time occupation.

(vii) Cottage industries are mostly operated in unorganized manner whereas the small industries are maintained to some extent in an organized manner.

(viii) Cottage industries are engaged in the production of traditional goods like earthen vessels, khadi goods, cotton and coir mattress, handmade shoes etc. whereas the small industries are engaged in sophisticated goods like electric fan and bulbs, radio, tape-recorders, television, mixer-cum-grinder etc.

However, the distinction between small industries and cottage industries are not rigid and definite made on the basis of well accepted universal principle. Such distinctions are usually made on the basis of certain observed characteristics and principles.

### Legal Framework

**Industries (Development and Regulation) Act, 1951 (IDRA),** which was enacted in pursuance of the Industrial Policy Resolution 1948. The Act was formulated for the purpose of development and regulation of industries in India.

The main objectives of the Act were: (i) to take necessary steps for the development of industries; (ii) to regulate the pattern and direction of industrial development and (iii) to control the activities, performance and results of industrial undertakings in the public interest. The Act applies to the 'Scheduled Industries' listed in the First Schedule of the Act. The Act comprises 32 sections out of which only two sections i.e., Sec 11B and Sec 29B relate to Small scale industrial undertaking.

**Sec 11B** of the said Act relates to the power of the Central Government to specify the requirements which shall be complied with by small scale industrial undertakings. It states that the Central Government may, with a view to ascertaining which ancillary and small scale industrial undertakings need supportive measures, exemptions or other favourable treatment to enable them to maintain their viability and strength so as to be effective in promoting in a harmonious manner the industrial economy of the country, easing the problem of unemployment and securing that the ownership and control of the material resources of the community are so distributed as best to serve the common good.

**Sec 29B** of the said Act relates to the powers of the Central Government to exempt in special cases. This section states that the Central Government by notifying in the Official Gazette shall exempt certain industries having regard to the smallness of the number of workers employed or to the amount invested in any industrial undertaking or to the desirability of encouraging small undertakings generally or to the stage of development of any scheduled industry, that it would not be in the public interest to apply all or any of the provisions of this Act. The exemption shall be from the applicability of the provisions of this Act or any Rule or Order made there under. 6

There was no special Act governing the micro, small and medium sectors except the above mentioned provisions of the IDRA Act 1951. There was a need for a comprehensive Central Law to provide an appropriate legislation for the sector to facilitate its growth, development and competitiveness. The emergence of a large service sector assisting the small industries also warrants a composite and comprehensive legal view over the previous Act which was not competitive to the present system of globalisation and liberalisation. Therefore, the Government of India presented a Bill in 2005 in Parliament i.e., known as the Micro, Small and Medium Enterprises Development Bill, 2005. This Bill was passed by both the Houses of the Parliament and took the assent of the President of India on 16th June, 2006 and became a law governing Micro, Small and Medium Enterprises Development in India.

**MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT 2006**

**Preamble:** “An Act to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.”

**The Objective of the Act is to seek the following:**

1. To provide for statutory definitions of “small enterprise” and “medium enterprise”;
2. Service Enterprises: The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment...
The Micro, Small and Medium Enterprises Development Act, (MSMED) 2006 is divided into six chapters. Each chapter is identified for a particular function:

Chapter-1 Preliminary with short title, definitions etc.,
Chapter-2 National Board for Micro, Small and Medium Enterprises
Chapter-3 Classification of Enterprises, Advisory Committee and Memorandum of Micro, Small and Medium Enterprises;
Chapter-4 Measures for promotion, Development and Enhancement of Competitiveness of Micro, Small and Medium Enterprises;
Chapter-5 Delayed Payments to Micro, and Small Enterprises;
Chapter-6 Miscellaneous, such as appointment of the officers and other employees, jurisdiction of courts, power to make rules etc."

The MSMED Act 2006 has in its 1st chapter defined certain terms which should have had a clear definition. These definitions have been given in the first chapter under the heading ‘conceptual definitions.’ In its 3rd chapter the Act has given a clear classification of the Small and Medium enterprises which is shown as follows.

CLASSIFICATION OF ENTERPRISES:

Section 7 of the MSMED Act 2006, classifies any class or classes of enterprises, whether proprietorship, Hindu undivided family, association of persons, co-operative society, partnership firm, company or undertaking etc., into two parts.

I. On the basis of the enterprises engaged in the manufacturing or production

Micro Enterprise Where investment in Plant and Machinery does not exceed 25 lakh rupees;
Small Enterprise Where investment in Plant and Machinery is more than 25 lakh rupees and less than 5 crore rupees;
Medium Enterprise Where investment in Plant and Machinery is more than 5 crore rupees and less than 10 crore rupees;

Note:
- a. It is very clearly mentioned in the Act that in calculating the investment in plant and machinery, the cost of pollution control, research and development, industrial safety devices and such other items is excluded.
- b. The reservation of items given in Sec 29 B of the Industries (Development and Regulation) Act is applicable to micro and small enterprises only.

II. On the basis of the enterprises engaged in providing or rendering of Services

Micro Enterprise Where investment in equipment does not exceed 10 lakh rupees;
Small Enterprise Where investment in equipment is more than 10 lakh rupees and less than 2 crore rupees;
Medium Enterprise Where investment in equipment is more than 2 crore rupees and less than 5 crore rupees;

Chapter-4 of the MSMED Act deals with the measures for promotion, development, and enhancement of competitiveness of micro, small and medium enterprises. It is relevant to note certain important provisions of the said Act which are culled out as under:

Sec 9 of the Act: Measures for promotion and development:
The Central Government may, from time to time, for the purposes of facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises, particularly of the micro and small enterprises, by way of development skill in the employees, management and entrepreneurs, make provisions for technological upgradation, marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages. The Government also may specify by notification, such programme, guidelines or instructions, as it may deem fit.

Sec 10 of the Act: Credit facilities
The policies and practices in respect of credit to the micro, small and medium enterprises, shall be progressive and such as may be specified in the guidelines or instructions issued by the Reserve Bank, from time to time, to ensure timely and smooth flow of credit to such enterprises, minimize the incidence of sickness among and enhance the competitiveness of such enterprise.

Sec 11: Procurement preference policy:
For facilitating promotion and development of micro and small enterprises, the Central Government or the State Government may, by order notify from time to time, Preference Policies in respect of procurement of goods and services, produced and provided by micro and small enterprises, by its Ministries or departments, as the case may be, or its aided institutions and public sector enterprises. Sec 12, 13 and 14 of the Act deals with the funds granted by the Government every now and then, any other grants by the Central Government and the administration and utilization of funds.

POLICIES IN GENERAL APPLICABLE TO SMALL SCALE UNDERTAKINGS:
The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry clearly states that the registration of an undertaking will not be necessary if an undertaking:

- Is a small scale industrial undertaking; or
- Is otherwise exempt from the licensing/registration provisions of the Act;
- Where the undertaking concerned does not satisfy the definition of the term ‘factory’ under the Act. As per the Act, it clearly states that where the number of workers employed is less than 50 where power is used or, less than 100 where no power is used, it would not be considered to be a factory under the Act and consequently, it would not be an ‘industrial undertaking’ for the purposes of this Act.

The small scale units can get registered with the Directorate of Industries/District Industries Center in the State Government concerned. These units can manufacture any item including those notified as exclusively reserved for manufacture in the small scale sector. Small scale units are also free from locational restrictions.

If a small scale manufacturing unit, exceeds the investment ceiling in plant and machinery by virtue of natural growth, needs to apply for and obtain a Carry-on Business (COB) license. No export obligation is fixed on the capacity for which the COB license is granted. However, if the unit expands the capacity for the small scale reserved item(s) further, it needs to apply for and obtain a separate industrial licence. It is very clear that all industries except those reserved for the public sector and those retained under compulsory licensing, engaged in the manufacture of items reserved for the small scale sector and if located in the restricted area according to their locations, are exempt from the requirements of obtaining Industrial license. The industrial undertakings which are exempt from obtaining an industrial licence are required to file an Industrial Entrepreneur Memorandum (IEM) with the Secretariat of Industrial Assistance (SIA), Department of Industrial Policy. The IEM has replaced the two stage registration process (provisional registration and permanent registration).

The MSMED Act makes it mandatory the filing of EM for a medium scale manufacturing enterprises and it is optional in case of other enterprises. The entrepreneurs are required to obtain Statutory clearances relating to Pollution Control and Environment for setting up an Industrial project. The Environment Protection Act 1986, states that any item reserved for the small scale sector with investment of less than Rs. 10 million is exempt from obtaining environmental clearance from the Central Government. Powers have been delegated to the State Government for grant of environmental clearance. The industrial undertakings are free to select the location of a project. However, in the case of cities with population of more than one million (as per the 1991 census), the proposed location should be at least 25 km away from the Standard Urban Area limits of that city unless, it is to be located in an area designated as an “industrial area” before 1991. Industries related to electronics, computer software and printing (and any other industry which may be notified in future as “non polluting industry”) are exempt from such locational restriction. The interest on delayed payments to small scale and ancillary industrial undertakings Act 1993 is “an Act to provide for and regulate the payment of interest on delayed payments to small scale and ancillary industrial undertakings and for matters connected therewith or incidental thereto.” Sec 32(1) of the MSMED Act has repealed the “The Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993”. This repeal is effective from the date notified by the Central Government i.e., 2-10-2006. However, according to the section 32(2) of the MSMED Act “notwithstanding such repeal, anything done or any action taken under the Act so repealed under sub sec(1) shall be deemed to have been done or taken under the corresponding provisions of this Act.”

The reason behind this repeal is that the provision under the Act was found inappropriate to the present market scenario and the working of the small and medium enterprises. It is known that the delayed payment from customers is one of the problems faced by the micro, small and medium enterprises. Therefore, the MSMED Act endeavours to incorporate more effective provisions to address this problem and also to provide a comprehensive legislative framework and policy to promote the development of small and medium enterprises.

PRESENT POLICY FRAMEWORK – MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006
The MSMED Act, 2006 is meant to encourage the development of the enterprises and also enhance their competitiveness. As already mentioned above it provides the first- ever legal framework for recognition of the concept of “enterprise” which comprises both manufacturing and service entities. It defines medium enterprises for the first time and sees to integrate the three segments, namely, micro, small and medium. The Act also provides for a statutory consultative mechanism at the national level with balanced representation of all sections of stakeholders, particularly the three classes of enterprises, and with a wide range of advisory functions. Under the Act specific funds are maintained for the promotion, development and enhancing competitiveness of these enterprises and notification of schemes/programs for this purpose are issued every now and then. Progressive credit policies and practices such as giving preference to the procurement of products and services of the micro and small enterprises, finding more effective mechanisms for mitigating the problems of delayed payments to micro and small enterprises and assurance of a scheme for easing the closure of business by these enterprises are implemented.

The Ministry of Micro, Small and Medium Enterprise has been continuously scrutinising the policy framework, the various schemes introduced and the various incentives and concessions given to the MSME sector in the country. The Ministry has identified the key areas which are in focus and they are the credit/finance sector, technology, quality control and certification, marketing, export promotion etc. The various State Governments on par with the Ministry of MSME have been providing schemes, incentives, subsidies, concessions, grants to the micro, small and medium enterprises in order to boost their economy, the Government of Karnataka is not behind in this regard.
Forms of business organization

Business concerns are established with the objective of making profits. They can be established either by one person or by a group of persons in the private sector by the government or other public bodies in the public sector. A business started by only one person is called sole proprietorship. The business started by a group of persons can be either a Joint Hindu Family or Partnership or Joint Stock Company or a Co-operative form of organization. Thus there are various forms of business organization.

1. Sole Proprietorship
2. Joint Hindu Family Firm
3. Partnership Firm
4. Joint Stock Company
5. Co-operative Society

Forms of business organization are legal forms in which a business enterprise may be organized and operated. These forms of organization refer to such aspects as ownership, risk bearing, control and distribution of profit. Any one of the above mentioned forms may be adopted for establishing a business, but usually one form is more suitable than other for a particular enterprise. The choice will depend on various factors like the nature of business, the objective, the capital required, the scale of operations, state control, legal requirements and so on. Out of the forms of private ownership listed above the first three forms (1, 2, and 3) may be described as non corporate and the remaining (4 and 5) as corporate forms of ownership. The basic difference between these two categories is that a non-corporate form of business can be started without registration while a corporate form of business cannot be set up without registration under the laws governing their functioning.

Characteristics of an ideal form of organization

Before we discuss the features, merits and demerits of different forms of organization, let us know the characteristics of an ideal form of organization. The characteristics of an ideal form of organization are found in varying degrees in different forms of organization. The entrepreneur, while selecting a form of organization for his business, should consider the following factors:

- **Ease of formation:** It should be easy to form the organization. The formation should not involve many legal formalities and it should not be time consuming.
- **Adequacy of Capital:** The form of organization should facilitate the raising of the required amount of capital at a reasonable cost. If the enterprise requires a large amount of capital, the preconditions for attracting capital from the public are a) safety of investment b) fair return on investment and c) transferability of the holding.
- **Limit of Liability:** A business enterprise may be organized on the basis of either limited or unlimited liability. From the point of view of risk, limited liability is preferable. It means that the liability of the owner as regards the debts of the business is limited only to the amount of capital agreed to be contributed by him. Unlimited liability means that even the owners’ personal assets will be liable to be attached for the payment of the business debts.
- **Direct relationship between Ownership, Control and Management:** The responsibility for management must be in the hands of the owners of the firm. If the owners have no control on the management, the firm may not be managed efficiently.
- **Continuity and Stability:** Stability is essential for any business concern. Uninterrupted existence enables the entrepreneur to formulate long-term plans for the development of the business concern.
- **Flexibility of Operations:** another ideal characteristic of a good form of organization is flexibility of operations. Changes may take place either in market conditions or the states’ policy toward industry or in the conditions of supply of various factors of production. The nature of organization should be such as to be able to adjust itself to the changes without much difficulty.

**1. Sole Proprietorship**

**Meaning:** A sole proprietorship or one man’s business is a form of business organization owned and managed by a single person. He is entitled to receive all the profits and bears all risk of ownership.

**Features:** The important features of sole proprietorship are:

1. The business is owned and controlled by only one person.
2. The risk is borne by a single person and hence he derives the total benefit.
3. The liability of the owner of the business is unlimited. It means that his personal assets are also liable to be attached for the payment of the liabilities of the business.
4. The business firm has no separate legal entity apart from that of the proprietor, and so the business lacks perpetuity.
5. To set up sole proprietorship, no legal formalities are necessary, but there may be legal restrictions on the setting up of particular type of business.
6. The proprietor has complete freedom of action and he himself takes decisions relating to his firm.
7. The proprietor may take the help of members of his Family in running the business.

**Advantages**

1. **Ease of formation:** As no legal formalities are required to be observed.
2. **Motivation:** as all profits belong to the owner, he will take personal interest in the business.
3. **Freedom of Action:** There is none to interfere with his authority. This freedom promotes initiative and self-reliance.
4. **Quick Decision:** No need for consultation or discussion with anybody.
5. **Flexibility:** Can adapt to changing needs with comparative ease.
6. **Personal Touch:** comes into close contact with customers as he himself manages the business. This helps him to earn goodwill.
7. **Business Secrecy:** Maintaining business secrets is very important in today’s competitive world.
8. **Social Utility:** Encourages independent living and prevents concentration of economic power.

**Disadvantages**

1. **Limited resources:** one man’s ability to gather capital will always be limited.
2. **Limited Managerial Ability**
3. Unlimited Liability: Will be discouraged to expand his business even when there are good prospects for earning more than what he has been doing for fear of losing his personal property.
4. Lack of Continuity: Uncertain future is another handicap of this type of business. If the sole proprietor dies, his business may come to an end.
5. No Economies of Large Scale: As the scale of operations are small, the owner cannot secure the economies and large scale buying and selling. This may raise the cost of production.

Suitability of Sole Proprietorship Form

From the discussion of the advantages and disadvantages of sole proprietorship above, it is clear that this form of business organization is most suited where:

1. The amount of capital is small
2. The nature of business is simple in character requiring quick decisions to be taken
3. Direct contact with the customer is essential and
4. The size of demand is not very large.

These types of conditions are satisfied by various types of small business such as retail shops, legal or medical accounting profession, tailoring, service like dry cleaning or vehicle repair etc. Hence, sole proprietor form of organization is mostly suitable for these lines of businesses. This form of organization also suits those individuals who have a strong drive for independent thinking and highly venturous some in their attitude.

2. Joint Hindu Family

Meaning: The Joint Hindu Family, also known as Hindu Undivided Family (HUF) is a non-corporate form of business organization. It is a firm belonging to a Joint Hindu Family. It comes into existence by the operations of law and not out of contract. In Hindu Law, there are two schools of thought viz Dayabhaga which is applicable in Bengal and Assam, and Mitakshara which is applicable in the rest of India. According to Mitakshara school, the property of the Joint Hindu Family is inherited by a Hindu Family from his father, grandfather and great grandfather, thus three successive generations in the male line (son, grandson and great grandson) can simultaneously inherit the ancestral property. They are called coparceners in interest and the senior most member of the family is called karta. The Hindu succession act 1956, has extended to the line of co-parceners interest to female relatives of the deceased co-parcener or male relative climbing through such female relatives. Under the Dayabagha law the male heirs become members only on the death of the father.

Features: Some of the important features of the Joint Hindu Family are as follows

1. The business is generally managed by the father or some other senior member of the Family he is called the Karta or the manager.
2. Except the Karta, no other member of the family has any right of participation in the management of a Joint Hindu Family firm
3. The other members of the family cannot question the authority of the Karta and their only remedy is to get the family dissolved by mutual agreement.
4. If the Karta has misappropriated the funds of the business, he has to compensate the other co-parceners to the extent of their share in the Joint property of the family
5. For managing the business, the Karta has the power to borrow funds, but the other coparceners are liable only to the extent of their share in the business. In other words the authority is limited.
6. The death of any member of the family does not dissolve the business of the family
7. Dissolution of the Joint Hindu Family can take place only through mutual agreement

Advantages

1. Stability: The existence of the HUF does not come to an end with the death of any coparcener, hence there is stability.
2. Knowledge and experience: There is scope for younger members of the family to get the benefit of the knowledge and experience of the elder members of the family.
3. No Interference: The Karta has full freedom to take decisions without any interference by any member of the family.
4. Maximum Interest: As the Karta’s liability is unlimited, he takes maximum interest in running the business.
5. Specialization: By assigning work to the members as per their knowledge and experience, the benefits of specialization and division of work may be secured.
6. Discipline: The firm provides an opportunity to its members to develop the virtues of discipline, self-sacrifice and co-operation.
7. Credit Worthiness: Has more credit worthiness when compared to that of a sole proprietorship.

Disadvantages

1. No Encouragement: As the benefit of hard work of some members is shared by all the members of the family, there is no encouragement to work hard.
2. Lazy and Inactive: The Karta takes the responsibility to manage the firm. This may result in the other members becoming lazy.
3. Members Initiative: The Karta alone has full control over the business and the other members cannot interfere with the management of the firm. This may hamper members initiative.
4. Duration: The life of the business is shortened if family quarrels take precedence over business interest.
5. Abuse of Freedom: There is scope for the Karta to misuse his full freedom in managing the business for his personal benefit.

Conclusion

This form of business organization which at one time was popular in India is now losing its popularity. The main cause for its decline is the gradual dissolution of the Joint Hindu Family system, it is being replaced by sole proprietorship or partnership firm.

3. Partnership Form of Organization

Generally when a proprietor finds it’s difficult to handle the problems of expansion, he thinks of taking a partner. In other words, once a business grows beyond the capacity of a sole proprietorship and or a Joint Hindu Family, it becomes unarguably necessary to form partnership. It means that partnership grows out of the limitations of one-man business in terms of limited financial resources, limited managerial ability and unlimited risk. Partnership represents the second stage in the evolution of ownership forms.

In simple words, a Partnership is an association of two or more individuals who agree to carry on business together for the purpose of earning and sharing of profits. However a formal definition is provided by the Partnership Act of 1932.

Definition
Section 4 of the Partnership Act, 1932 defines Partnership as “the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all”

**Features of Partnership**

1. **simple procedure of formation**: the formation of partnership does not involve any complicated legal formalities. By an oral or written agreement, a Partnership can be created. Even the registration of the agreement is not compulsory.

2. **Capital**: The capital of a partnership is contributed by the partners but it is not necessary that all the partners should contribute equally. Some may become partners without contributing any capital. This happens when such partners have special skills, abilities or experience. The partnership firm can also raise additional funds by borrowing from banks and others.

3. **Control**: The control is exercised jointly by all the partners. No major decision can be taken without consent of all the partners. However, in some firms, there may partners known as sleeping or dormant partners who do not take an active part in the conduct of the business.

4. **Management**: Every partner has a right to take part in the management of the firm. But generally, the partnership Deed may provide that one or more than one partner will look after the management of the affairs of the firm. Sometimes the deed may provide for the division of responsibilities among the different partners depending upon their specialization.

5. **Duration of partnership**: The duration of the partnership may be fixed or may not be fixed by the partners. In case duration is fixed, it is called as “partnership for a fixed term.” When the fixed period is over, the partnership comes to an end.

6. **Unlimited Liability**: The liability of each partner in respect of the firm is unlimited. It is also joint and several and, therefore, any one of the partners can be asked to clear the firm’s debts in case the assets of the firm are inadequate for it.

7. **No separate legal entity**: The partnership firm has no independent legal existence apart from that of the persons who constitute it. Partnership is dissolved when any partner dies or retires. Thus it lacks continuity.

8. **Restriction on transfer of share**: A partner cannot transfer his share to an outsider without the consent of all the other partners.

9. **Advantages**

   1. **Ease of formation**: Partnership can be easily formed without expense and legal formalities. Even the registration of the firm is not compulsory.
   2. **Large resources**: when compared to sole-proprietorship, the partnership will have larger resources. Hence, the scale of operations can be increased if conditions warrant it.
   3. **Better organization of business**: as the talent, experience, managerial ability and power of judgment of two or more persons are combined in partnership, there is scope for a better organization of business.
   4. **Greater interest in business**: as the owners of the business and as profit from the business depends on the efficiency with which they manage, they take as much interest as possible in business.
   5. **Prompt decisions**: as partners meet very often, they take decisions regarding business policies very promptly. This helps the firm in taking advantage of changing business conditions.
   6. **Balance judgement**: as partners possess different types of talent necessary for handling the problems of the firm, the decisions taken jointly by the partners are likely to be balanced.
   7. **Flexibility**: partnership is free from legal restriction for changing the scope of its business. The line of business can be changed at any time with the mutual consent of the partners. No legal formalities are involved in it.
   8. **Diffusion of risk**: the losses of the firm will be shared by all the partners. Hence, the share of loss in the case of each partner will be less than that sustained in sole proprietorship.
   9. **Protection to minority interest**: important matters like change in the nature of business, unanimity among partners is necessary hence, the minority interest is protected.
   10. **Influence of unlimited liability**: the principle of unlimited liability helps in two ways. First, the partners will be careful in their business dealings because of the fear of their personal properties becoming liable under the principle of unlimited liability. Secondly, it helps the firm in raising loans for the business as the financiers are assured of the realization of loans advanced by them.

10. **Disadvantages**

    1. **Great risk**: as the liability is joint and several, any one of the partners can be made to pay all the debts of the firm. This affects his share capital in the business and his personal properties.
    2. **Lack of harmony**: some frictions, misunderstanding and lack of harmony among the partners may arise at any time which may ultimately lead to the dissolution.
    3. **Limited resources**: because of the legal ceiling on the maximum number of partners, there is limit to the amount of capital that can be raised.
    4. **Tendency to play safe**: because of the principle of unlimited liability, the partners tend to play safe and pursue unduly conservative policies.
    5. **No legal entity**: the partnership has no independent existence apart from that of the persons constituting it, i.e., it is not a legal entity.
    6. **Instability**: the death, retirement, insolvency of a partner leads to the dissolution of the partnership. Further even any one partner if dissatisfied with the business, can bring about the dissolution of partnership. Hence partnership lacks continuity.
    7. **Lack of public confidence**: no legal regulations are followed at the time of the formation of partnership and also there is no publicity given to its affairs. Because of these reasons, a partnership may not enjoy public confidence.

**Sustainability**: the advantages and drawbacks of partnership stated above indicate that the partnership form tends to be useful for relatively small business, such as retail trade, mercantile houses of moderate size, professional services or small scale industries and agency business. But when compared to sole proprietorship partnership is suitable for a business bigger in size and operations.

4. **Joint-Stock Company**

The most important type of business organization today is the joint stock company. In fact, only in this manner can a business be organized on a respectable scale.

**Joint-Stock Company and Partnership Compared**

From the above description of a joint stock company, we can easily notice some essential features which distinguish it from a partnership. The number of shareholders in a company is very much larger than in a partnership. It may run into thousands, and they are scattered through the length and breadth of the country, sometimes the world. The number of partners, however, is generally very small and the contact between them is close and continuous.

**The financial resources of a joint-stock company are much larger:**
No partnership can raise so much capital. Since the partnership cannot sell shares, it has to depend on its own resources. The liability is limited in a joint-stock company, whereas it is unlimited in the case of partnership. A partner can be called upon to pay the entire debt of the business; even his private property can be attached. But the liability of a shareholder in a company is limited to his share capital only. The company is a legal person and, as such, it can sue and be sued upon. In the partnership, the partner can sue and be sued up in personally, and right in the name-of the firm. Being a legal person a company can own property and enter into business contracts.

**The existence of a limited company has a legal sanction:**
It is brought into existence according to an Act of the State and works under the supervision of law. The partnership comes into the grip of law only when the law is invoked against it. The partnership can change in any lawful business? But a company cannot go beyond what has been laid down in the Memorandum of Association.

**A company has a perpetual existence:**
The retirement or death of a shareholder or a director cannot bring about the dissolution of a company. But a partnership comes to an end when a partner retires, dies, or if he becomes instance or bankrupt. Hence, a company is a permanent body and can go on forever. Personal relationship is of no importance in a company, whereas it is vital in a partnership. This is shown by the fact that a shareholder may sell his shares without the consent of the company. But no partner can transfer his interest in the firm to another person without the consent of all other partners.

In a partnership, the owners themselves manage the business. In fact, every partner has a right to take part in business management. But in a company the shareholders, who are the owners of the company, entrust the work of management to a board of directors. Ownership is thus separated from control.

**Merits of Joint-Stock Organisation:** Let us now enumerate the merits of the joint-stock type of organisation:

(i) **Economies of Large Scale:** The large financial resources of the company enable it to undertake business on a scale large enough to realise internal and external economies of scale. These economies are: use of modern machinery, division of labour, economies in buying and selling, lower overhead charges relating to distribution, publicity and administration, research and experiments, etc.

(ii) **Limited Liability:** It is a great advantage to have the liability limited. The shares are of different kinds and the value of each share is quite low. This attracts all sorts of people, rich and poor, rash and prudent, to invest their capital. Large funds can thus easily be raised which would not have been possible if the liability were unlimited.

(iii) **Shares Transferable:** A shareholder can sell his shares whenever he likes. He is not tied for life to the fortunes of a company. When he needs money he can get it by selling his shares. Thus the investment is quite convenient.

(iv) **Economical Administration:** The directors have not to be paid salaries but just a fee for attending the Board meeting. Thus the company can get the advice of people of mature wisdom and ripe experience at a small cost. The administration is, therefore, economical.

(v) **Democratic:** The directors can be removed by the shareholders, if they are not found satisfactory. The company is therefore a democratic organisation. It is the will of the general body of the shareholders that is supreme.

(vi) **Permanent Existence:** The company has a perpetual existence. Any number of shareholders may leave it, but the company continues. It can thus afford to launch enterprises which may reach the stage of profit-taking after a long time.

(vii) **Thrift Encouraged:** By affording opportunities of investment even to men of small means, the company organisation encourages thrift and saving in the country. This type of organisation is a great aid in capital formation.

(viii) **Legal Control:** The Government exercises control over the working of the company. It has to conform to certain legal requirements. The object is to prevent fraud and to protect the interests of the shareholders and the public at large.

(ix) **Risks spread out:** This type of organisation enables the individual investor to spread out his risks. Instead of starting a business of his own, he can buy the shares of a number of joint-stock companies. He need not put all his eggs in one basket. These are some of the advantages associated with joint-stock from business organisation.

**Demerits:** As against the advantages mentioned above, there are certain drawbacks too in the company form of organisation

(i) **Rash Enterprises:** The limited liability may encourage rash enterprises to be launched. It is the shareholders’ money that is involved and the decisions are taken by the directors. One is tempted to play ducks and drakes with other people’s money.

(ii) **Shareholders Indifferent:** The transferability of shares kills the interest of the shareholders in the company. On account of the indifference of shareholders, the directors are all in all. They often promote their own interests at the expense of the company.

(iii) **Democratic only in Theory:** The directors, self-elected at first, manage to get themselves re-elected every time by securing proxies. The shareholders who should have ultimate authority feel helpless.

(iv) **Fraud and Exploitation:** The shareholders are exploited by dishonest directors. Frauds are common. This frightens away the prospective investor and capital becomes shy.

(v) **Lacking Adaptability:** A company lacks the adaptability and vigour of a partnership. It is a slow-moving machine. Quick decisions are not possible. This form of business organisation is thus more suited to business that can be reduced to a routine. When quick decisions are necessary, it is not suitable.

(vi) **Lack of Personal Touch:** The owners of the company, i.e., the shareholders, have no personal touch with the employees. This impersonal and unsympathetic role results in employees being often exploited in the name of the shareholders. There are often labour troubles.

**Conclusion:**
Weighing advantages and disadvantages, we can say that, on the whole, a joint-stock company is very desirable and beneficial. This form of business has come to stay and no country can do without it. First class business can be run only in this form of organisation.

5. **Co-Operative Organisation:** Another form of business organisation is co-operative enterprise. Co-operation is broadly of two types, namely, (1) Producers’ co-operation, and (2) Consumers’ co-operation.

(1) **Producers’ Co-operation:** In this form of co-operation, the workers are their own masters. The business is owned by them. They elect managers and foremen. They are their own employees. The profits, if any, are divided among them all. The scheme is very attractive. The “accursed” entrepreneur is done away with and the profits, instead of enriching a few individuals, go to the actual workers. Nothing could be more attractive and fairer than this. The workers are supposed to put in very hard work; and there
are no strikes or lock-outs. Co-operation is educationally and morally useful. It encourages thrift among the workers and prevents them from being exploited. It teaches them how to run a business and to work in a team spirit.

This, however, is all theory. Actually, co-operative enterprise has proved a failure. It has generally not achieved the results expected of it. The members are not able to raise sufficient capital and employ good managers. The workers show lack of discipline and often refuse to obey orders of their managers. Bickering’s are common. The workers have powers, but lack of the sense of responsibility. They cannot make success of a business.

(2) Consumers’ Co-operation: The consumers living in a particular place, or working in an establishment, combine together. Each contributes a small capital. A store is opened in which articles of common use are stocked. Such co-operative stores are found in many colleges schools and other establishments. Usually goods are sold at market price, and points are distributed among the shareholders. This form of co-operation has been very successful. The consumers feel deeply interested in their own store and extend to it their unfailing patronage. Not much capital is needed. The management is simple and honorary. There is legal control and inspection which keep these cooperatives straight.

The drawbacks or the consumers’ cooperatives are that they cannot finance, expanding business. They offer very little selection for the consumers. The honorary office-holder do not take pains. Besides being inefficient they are sometimes dishonest. Still the co-operative stores are very common and are fairly successful.

(3) Other Forms of Co-operation: The principle of co-operation has been given a very extended application. Co-operative societies have been formed for a number of purposes. Primary co-operative credit societies exist in our villages. They are meant to help the small villagers with loans for useful purposes.

The aim of such societies is not merely to supply the monetary needs of the farmers, but also to teach them self-help and thrift. These village societies, when they need more money, are helped with loans from the central co-operative think in the district towns, which, in their turn, are aided with funds by the State Co-operative Bank.

Besides such co-operative credit societies in the villages, there are co-operative societies for all sorts of purposes, credit and non-credit, e.g., for running schools and libraries, for killing mosquitoes, for purchasing seeds and cattle, for sale of milk, ghee, fruits, sugar-cane, for consolidation of holdings, and what not.

Principles of Co-operation: The main principles of co-operation are:

(i) Management is democratic and honorary
(ii) It is based on mutual help and. self-reliance, “Each for all and all for each”.
(iii) Its aim is not merely to promote the economic interests of its members, but it is valued also for its educative and moral advantages. As Parting says in his book “Punjab Peasant in Prosperity and Debt”, “Where there is a good co-operative society drink and gambling are at a discount.”
(iv) Honesty is capitalised, i.e., loans are given mostly on personal security.
(v) Loans are given as far as possible for productive purposes only.
(vi) In rural societies, the liability is unlimited, whereas in urban societies it is limited.
(vii) In rural societies, there is little share capital and profits go to an inalienable reserve fund. Urban societies have share capital and can distribute dividends.

Co-operation avoids the drawbacks of capitalistic organisation, “such as waste, exploitation of workers, absence of any voice iii the management, denial to workers of any share in the profits.” Further, it is free from excessive individualism and self-interest which is a predominant feature of capitalism.

On the other hand, co-operation also avoids the shortcomings of socialism. Under socialism, there is too great a suppression of the individual and there is excessive interference on the part of the State. Stimulus of self-interest is absent. But co-operation reconciles self-interest of the individual with the common interest of all.

Thus, co-operation combines the advantage of both capitalism and socialism and avoids the disadvantages of both.

Co-operative Organisation and Joint-stock Companies Compared:

In size, working and administration, the two types may look alike but there are several differences between the two:

(i) The members of a co-operative organisation are generally known to one another and in some cases very intimately. But the shareholders of a joint-stock company are not supposed to have any contact with one another.
(ii) The members of a co-operative belong to a certain place or to the same class of people. But the shareholders are widely scattered and have nothing else in common.
(iii) The management in both cases is elected but the process is more democratic in a co-operative society, for the rule is ‘one man, one vote’. A shareholder of a joint-stock company commands votes according to the amount of the share capital. Thus, the bigger shareholders exercise larger number of votes than the smaller ones and the voting is by proxy.
(iv) In a co-operative society, the management is more responsive to the general body than is the case in a joint-stock company.
(v) In a co-operative society, the members take a very active interest in the affairs of the society. But the shareholders of a joint stock company are notoriously indifferent.
(vi) The shares are much less frequently transferred in a co-operative society than in a joint-stock company.
(vii) In some forms of co-operative societies, e.g., rural credit societies, the liability is unlimited. In a joint stock company, the liability is limited.
(vii) Profit is the main motive in a joint-stock company. But in some co-operative societies, profits are not divisible. They go to the reserve fund and a portion is spent on educational or charitable purposes.

(ix) Moral and educational aspect in a co-operative is as important as the economic aspect. But in a joint-stock company, economic consideration is the only consideration.

(x) These are a few points which distinguish a co-operative society from a joint-stock company.

Typical Organizational Structure of a Small Business

A small business can use one of three primary organization structure options: functional, divisional or matrix. Essentially, the organizational structure creates a business hierarchy to increase the efficiency and effectiveness of the business operations. Different small businesses operate in different ways, so there is no one-size-fits-all solution every small business should choose for an organizational structure. You can, however, determine which of the most common structures works for your business.

1. **Functional** - When you establish a functional organizational structure, you are building a hierarchy based on the job role of each employee. Functional organizational structure groups together employees who work toward a common goal. For example, all of your marketing employees would be in the same group. Even if you only have two or three employees who fulfill the marketing role of your small business, you would structure it so one person is in charge, such as the vice president of marketing. His team would consist of a marketing manager and a public relations manager. The functional structure provides focus to the employees, because they know they are working toward a common goal. In this example, the common goal is marketing and promoting the business.

2. **Divisional** - Divisional organizational structures decentralize the functional organizational structure because the roles of the employees are divided by product or region, rather than function, within your business. For example, you could divide the United States into four divisions: north, east, south and west. Each division would then have its own employees. This provides each region with specialist in each area for that region. If your business sells different products, you can also separate roles by the product under a divisional organizational structure.

3. **Matrix** - Matrix organizational structures combine the characteristics of a functional and divisional organizational structure. The matrix organizational structure works more like a team. Instead of department heads, each team has a leader. Matrix organizational structures bring together employees who focus on a project, but fill different roles from across your business. The matrix organizational structure has the most decentralization, which means it can confuse employees about who is in charge. The matrix organizational structure is appropriate if your business operates on an international level, or serves different geographic regions.

4. **Trial and Error** - Many small business owners start off by structuring the business by trial and error, or in a haphazard manner. You could start the business with just you and an assistant until you learn more about the roles employees must fill within the organization.

5. **Changing Structures** - When your business starts small and then grows, it is not uncommon to start with one organizational structure and then transition to another structure. For example, if your business starts out by only serving the local city where the business operates, but eventually serves the state, you might start with one structure and change to another one to better fit the needs of your business and its customers.

Feasibility Study Report (FSR)

Conducting a feasibility study is one of the key activities within the project initiation phase. It aims to analyze and justify the project in terms of technical feasibility, business viability and cost-effectiveness. The study serves as a way to prove the project’s reasonability and justify the need for launch. Once the study is done, a feasibility study report (FSR) should be developed to summarize the activity and state if the particular project is realistic and practical. Let’s find out what FSR means, why it’s important and how to write it.

FSR Definition

What is a feasibility study report (FSR)? In simple terms, it’s just a document that aims to identify, explore, and evaluate a project’s solutions to save time and money. The following definition gives a broader understanding of the document:

A Feasibility Study Report (FSR) is a formally documented output of feasibility study that summarizes results of the analysis and evaluations conducted to review the proposed solution and investigate project alternatives for the purpose of identifying if the project is really feasible, cost-effective and profitable. It describes and supports the most feasible solution applicable to the project. The report gives a brief description of the project and some background information. Formally this document is the starting point for running the Pre-Charter Sub-Phase. In practice, it signifies that the sponsor can proceed with deciding on project investment and make necessary assignments to the project manager.

FSR Importance

The process to write the report is called feasibility study reporting. Often it is a responsibility of the project manager to control such a process. The importance of writing the report consists in providing legal and technical evidence of the project’s viability, sustainability and cost-effectiveness. The reporting process allows the senior management to get the necessary information required for making key decisions on budgeting and investment planning. A well-written feasibility study report template lets develop solutions for:

1. Project Analysis because an example of FSR helps link project efficiency to budgeted costs.
2. Risk Mitigation because it helps with contingency planning and risk treatment strategy development.
3. Staff Training because the report can be used by senior management to identify staffing needs as well as acquire and train necessary specialists.

The process of reporting is the trigger to run the project investing process through underpinning the business case document, stating the reasons for undertaking the project, and analyzing project costs and benefits.

Steps To Writing A FSR Example

How to write a feasibility study report? Regardless of project size, scope and type, there are several key steps to writing such an important document. Let’s view the steps in detail:

1. **Write Project Description** - At this step, you need to collect background information on your project to write the description. For example, your company needs to increase online sales and promote your products/services on the Web. Then in the first part of your report you could write the next description:
This project is website development to promote the products/services in Internet and increase online sales through encouraging customers to visit the website and make online bargains.”

2. **Describe Possible Solutions** - In order to take this step to write a feasibility study report template, you’ll need to perform an alternatives analysis and make a description of possible solutions for your project. For example, in your FSR template your e-commerce project might have the following solutions description:

“This project can be undertaken by the implementation of the two possible solutions: 1) Online Shop; 2) Corporate Website. Each of the solutions is carefully analyzed, and necessary information required for making the final decision is available for the management team.”

3. **List Evaluation Criteria** - Now it’s time to set and define evaluation criteria for possible solutions. This step of feasibility study report writing requires you to investigate the solutions and put them against a set of evaluation criteria. For example, you could add the following criteria to your report:

“The possible solutions of this project are evaluated and compared by the following criteria: 1) Concept Spec.; 2) Content Audit; 3) Technical Design Spec.; 4) Launch Schedule & Time-frames.”

4. **Propose The Most Feasible Solution** - Once the criteria are used to evaluate the solutions, your next step for writing a feasibility study report is to determine the most economically reasonable and technically feasible solution which lets the company 1) keep to optimal use of project resources and 2) gain the best possible benefit. For example, your report might include:

“After the evaluation of the possible solutions, the most feasible solution for this project is identified and selected, so the project turns to be cost-effective, vital and practical.”

5. **Write Conclusion** - The final step of the feasibility study reporting process requires you to make a conclusion by summarizing the project’s aim and stating the most feasible solution. For example, the conclusion of your FSR might be:

“This project’s purpose is to develop a sophisticated and original design of the website that will contribute to online sales increasing, attract the target customer’s attention, and be cost-effective. The most feasible solution for the project has been chosen and approved and now is ready for further elaboration.”

Also, look at this Project Feasibility and Option Analysis Template to find out how to perform an analysis of alternative approaches.

**Content Requirements For Sample Feasibility Report**

The content of sample feasibility report is formatted and structured according to a range of requirements which may vary from organization to organization. Meanwhile, there are common suggestions, which are listed below.

**Front Matter**

To begin with writing a sample feasibility report, first you need to create a title page that provides a descriptive yet concise title, your (i.e. author’s) name, email, job position, and also the organization for which you’re writing the report. Next, you must include an itemized list of contents that provides headings and sub-headings sequenced the same way as they are structured in the report body. Also add a list of all material (tables, figures, illustrations, annexes) used within the doc. Remember that the title page shouldn’t be numbered and that no more than 4-5 pages should be dedicated to the front matter.

**Report Body Format**

Because there are many different styles and requirements for formatting the body of feasibility study report, it may be difficult for you to select right format for your report, so I suggest you discuss this issue with your curator or supervisor who should provide you with right styling and format requirements.

**Meanwhile, there are several common suggestions as follows:**

1. Each page of the report body needs to include a descriptive header with an abbreviated title for the report, the author’s name and page number (at the right top)
2. Structure the report by headings and sub-headings and indicate this structure within the document content
3. Make sure headings are properly formatted (i.e., flush left, indented, etc.) on each page
4. Use the same style for headings throughout the entire report template
5. Never use too larger or too small font (font should have a professional look, 10-12 point)
6. Use the same citation style (e.g., CBE, APA, etc.) for formatting sources used in your feasibility study template

**Report Template Sections** The following list provides an outline of the key sections to be included in report content:

1. **Executive Summary** – a summary of the problem/opportunity highlighted in the study, the purpose of the report, and the importance of the research for your target audience
2. **Background** – a more detailed description of the feasibility study, who it was carried out and, whether it was implemented elsewhere
3. **Analysis** – an examination and evaluation method employed in the conducting your feasibility study
4. **Alternatives and Options** – an overview of any alternative proposals or options and their features in comparison to the main proposal of the study
5. **Cost-Benefit Evaluation** – a rigorous analysis method that was implemented to examine and evaluate the main proposal for cost-benefit effectiveness and to demonstrate the tech feasibility, economic practicality, social desirability, and eco soundness of the proposal.
6. **Conclusion** – a summary of the work done and your own conclusions regarding your analysis
7. **Recommendations** – a series of recommendations practices and follow-up actions based on your conclusions

**How to Write a Feasibility Report on Starting a Small Scale Fish Farm**

Fish farming or aquaculture is a growing industry full of opportunities due to the increased demand for fish as a source of important nutrients for healthy living. A small scale fish farm is relatively easy to establish since the requirements are minimal and the start-up costs are not overwhelming. A feasibility report analyzes an intended project in terms of its viability, start-up costs and profitability. An ideal small scale fish farming feasibility report should include the following steps.

1. **Introduction.** The introduction part of the feasibility report should outline the importance and the advantages of small scale fish farming. Explain your project fully in this section. Outline briefly how the project will be rolled out, how you plan to benefit from the project and the processes that will be involved. Basically it is a summary of the small scale fish farming project.
2. Description of the project. In this section, clearly outline the project’s location, the environment surrounding it and the availability of the resources required to start a small scale fish farm. Highlight the project’s mission and vision. Business goals and the objectives should also be included. Also include a brief history of the project and what motivated you to start the fish farm.

3. Market description. Describe the type of industry you will be operating in, whether you will be selling your products as a wholesaler or a retailer. Identify your target market and how you plan to penetrate that market. Outline the marketing strategies you will employ to market your fish.

4. Description of your products. Highlight different species of fish that you will be rearing. Describe how you selected those species. Explain the pricing of your products and the competitive edge your fish products have over other products in the market.

5. Organization plan Outline the legal structure under which the small scale fish farm will operate, whether it will be a sole proprietorship, partnership or a limited liability company. Identify the type of permits and licenses that will be required for the project. Explain the number of staff and their qualifications that will be necessary to successfully run the fish farm. Outline how they will be organized in terms of duties and responsibilities.

6. Marketing plan. Illustrate how you plan to conduct your market research to identify how you will segment your market and how you plan to satisfy each market segment. Market segmentation entails identifying the different portions of the market that are different from one another in terms of lifestyle, income levels, location and spending habits. Explain the strategies that will be used in the sale and distribution of your fish to each market segment to satisfy their unique needs. Also include the strategies you will employ to effectively compete with your competitors in the market.

7. Financial management. Identify the intended sources of capital for your fish farm and how you plan to use this capital in your venture. Outline how the profits will be used to enhance the fish farm and the measures that will be put in place to prevent or reduce losses. In this step you should also be able to show the projected cash flow statement, income statement and the balance sheet statement for the next 12 months.

8. Conclusion Give your recommendations and conclusion in this section on the viability of the small scale fish farm.

SSI Registration

Small Scale and ancillary units (i.e. undertaking with investment in plant and machinery of less than Rs. 10 million) should seek registration with the Director of Industries of the concerned State Government.

Registering your SSI Unit

The main purpose of Registration is to maintain statistics and maintain a roll of such units for the purposes of providing incentives and support services.

States have generally adopted the uniform registration procedures as per the guidelines. However, there may be some modifications done by States. It must be noted that small industries is basically a state subject. States use the same registration scheme for implementing their own policies. It is possible that some states may have a 'SIDO registration scheme' and a 'State registration scheme'.

Benefits of Registering

The registration scheme has no statutory basis. Units would normally get registered to avail some benefits, incentives or support given either by the Central or State Govt. The regime of incentives offered by the Centre generally contains the following:

- Credit prescription (Priority sector lending), differential rates of interest etc.
- Excise Exemption Scheme
- Exemption under Direct Tax Laws.
- Statutory support such as reservation and the Interest on Delayed Payments Act.

( It is to be noted that the Banking Laws, Excise Law and the Direct Taxes Law have incorporated the word SSI in their exemption notifications. Though in many cases they may define it differently. However, generally the registration certificate issued by the registering authority is seen as proof of being SSI).

States/UTs have their own package of facilities and incentives for small scale. They relate to development of industrial estates, tax subsidies, power tariff subsidies, capital investment subsidies and other support. Both the Centre and the State, whether under law or otherwise, target their incentives and support packages generally to units registered with them.

Objectives of the Registration Scheme - They are summarised as follows:

- To enumerate and maintain a roll of small industries to which the package of incentives and support are targeted.
- To provide a certificate enabling the units to avail statutory benefits mainly in terms of protection.
- To serve the purpose of collection of statistics.
- To create nodal centres at the Centre, State and District levels to promote SSI.

Features of the Scheme - Features of the scheme are as follows:

- DIC is the primary registering centre
- Registration is voluntary and not compulsory.
- Two types of registration is done in all States. First a provisional registration certificate is given. And after commencement of production, a permanent registration certificate is given.
- PRC is normally valid for 5 years and permanent registration is given in perpetuity.

Provisional Registration Certificate (PRC)

- This is given for the pre-operative period and enables the units to obtain the term loans and working capital from financial institutions/banks under priority sector lending.
- Obtain facilities for accommodation, land, other approvals etc.
- Obtain various necessary NOCs and clearances from regulatory bodies such as Pollution Control Board, Labour Regulations etc.
Permanent Registration Certificate - Enables the unit to get the following incentives/concessions:
- Income Tax exemption and Sales Tax exemption as per State Govt. Policy.
- Incentives and concessions in power tariff etc.
- Price and purchase preference for goods produced.
- Availability of raw material depending on existing policy.
- Permanent registration of tiny units should be renewed after 5 years.

Procedure for Registration - Features of the present procedures are as follows:
- A unit can apply for PRC for any item that does not require industrial license which means items listed in Schedule-III and items not listed in Schedule-I or Schedule-II of the licencing Exemption Notification. Units employing less than 50/100 workers with/without power can apply for registration even for those items included in Schedule-II.
- Unit applies for PRC in prescribed application form. No field enquiry is done and PRC is issued.
- PRC is valid for five years. If the entrepreneur is unable to set up the unit in this period, he can apply afresh at the end of five years period.
- Once the unit commences production, it has to apply for permanent registration on the prescribed form.

The following form basis of evaluation:
- The unit has obtained all necessary clearances whether statutory or administrative. e.g. drug license under drug control order, NOC from Pollution Control Board, if required etc.
- Unit does not violate any locational restrictions in force, at the time of evaluation.
- Value of plant and machinery is within prescribed limits.
- Unit is not owned, controlled or subsidiary of any other industrial undertaking as per notification.

De-Registration - A Small Scale Unit can violate the regulations in the following ways which will make it liable for de-registration:
- It crosses the investment limits.
- It starts manufacturing any new item or items that require an industrial license or other kind of statutory license.
- It does not satisfy the condition of being owned, controlled or being a subsidiary of any other industrial undertaking.

What is SSI/MSME Registration?
Small Scale Industries (SSI) or Micro, Small and Medium Enterprises (MSME) can register themselves under the MSMED Act. It isn’t necessary, but very beneficial to do so, as it only exists to offer benefits to those registered under it. These benefits include priority sector lending, excise and direct tax exemptions, capital investment subsidies and power tariff subsidies. To qualify as an MSME, manufacturing enterprises need to have investment of less than Rs. 10 crore in plant and machinery, while service enterprises must have no more than Rs. 5 crore invested in plant and machinery. If, at any time, you cross this investment limit, you need to cancel your registration under the MSMED Act.

6 Essential Facts on SSI/MSME Registration

What is an SSI/MSME Registration?
Every nation’s economic hopes are pinned on its young, small businesses. The Indian government, with this in mind, offers numerous benefits to such organisations (cheaper credit, easy loan approval, tax exemptions, etc), so that they can achieve growth at a much faster pace and without enduring hardships. To avail of these benefits, the organisations that qualify must get an MSME or SSI Registration (regulated by the MSMED Act). This registration is among one of the easiest of government registrations to be granted.

Is SSI/MSME Registration voluntary or mandatory?
The SSI Registration is only needed to avail of subsidies and benefits. It is absolutely voluntary. However, as it is a fairly easy registration to get quickly (provided you have a manufacturing plant or a commercial space where you render services), many business opt for it over other registrations.

Why should I apply before commencing operations?
This is because you can avail of a Provisional SSI Registration Certificate (PRC). The PRC will enable the unit to obtain term loans and working capital under priority sector lending and make it easier to procure various NOCs and clearances from regulatory bodies, such as Pollution Control Board.

What documents are required for the application?
You may apply for the PRC without an industrial license in case your unit is listed in Schedule-III of the Industrial Licensing Exemption Notification. Other units must first acquire an industrial license. The unit should also have obtained all other clearances, whether statutory or administrative. For example, a drug license under the drug control order or an NoC from Pollution Control Board, if required. The unit should not violate any locational restrictions in force. The unit should not be owned, controlled or subsidiary of any other industrial undertaking. The PRC is issued based on the application form. No field enquiry is made.

What are the advantages of SSI registration?
The benefits range from cheaper bank loans, easy access to credit, quicker approvals from state and central government bodies, tax rebates, cheaper infrastructure, including electricity and VAT exemptions.

Why is it essential to maintain records?
Any entity with an SSI Registration that fails to follow any regulations laid by the government will be deregistered. Also, in case you exceed the investment limits, as noted below, your firm’s registration will be cancelled.

What You Need To Know

Micro Enterprises - Micro enterprises are the smallest entities, of course. Micro manufacturing enterprises have investment of less than Rs. 25 lakh in plant and machinery, while micro service enterprises have less than Rs. 10 lakh invested.

Small Enterprises - Small manufacturing enterprises may have between Rs. 25 lakh and Rs. 5 crore invested in plant and machinery, while small service enterprises may have between Rs. 10 lakh and Rs. 2 crore invested.
Medium Enterprises - Medium manufacturing enterprises may have between Rs. 5 crore and Rs. 10 crore invested in plant and machinery, while small scale enterprises may have between Rs. 2 crore and Rs. 5 crore invested.

FAQs on SSI/MSME Registration

1. For how long is a Provisional Registration Certificate (PRC) valid?

The PRC expires at the end of five years, at which point you may re-apply if the unit is not yet operational, or if the unit exceeds investment limits set by the MSMED Act. Once you commence operations, you can apply for the Permanent License.

2. What factors are not counted as investment?

For a registration, total plant and machinery cost should be up to Rs. 25 crore for manufacturing units and Rs. 10 crore for service units. While calculating this number, the value of land and building will not be counted toward the total investment. Also, the original cost of the equipment and plant and machinery is taken into account. Depreciation cannot be factored in.

3. How does SSI/MSME help me get a loan from a bank?

All banks and other financial institutions recognise MSMEs and have created special schemes for them. This usually includes priority sector lending, which means that the likelihood of your business being sanctioned a loan is high. Bank loan interest rates will also be lower. There may also be preferential treatment in case of delay in repayment.

4. What benefits are given by state and central government?

Most states offer those units registered under the MSMED Act a subsidy on power, taxes, and entry to state-run industrial estates. In particular, there is a sales tax exemption in most states and purchase preferences on goods produced. Depending on your business, you may also enjoy an excise exemption scheme and exemption from certain direct taxes in the initial years of your business.

Licensing

Licensing in the industries sector is governed by the Licensing Exemption Notification issued by Government of India on July 25, 1991 under the Industries (Development and Regulation) Act, 1951. In the case of SSIs, there are virtually no licensing restrictions. No industrial license is required except in case of six product groups included in compulsory licensing. These product groups include distillation and brewing of alcoholic drinks, cigars and cigarettes of tobacco and manufactured tobacco substitutes, electronic aerospace and defence equipment of all types, industrial explosives (including detonating fuses, safety fuses, gun powder, nitrocellulose and matches), hazardous chemicals extending to hydrocyanic acid and its derivatives, phosgene and its derivatives, isocyanates of hydrocarbon, not elsewhere specified. These are mainly cover products that can only be made in large sector. But if a small-scale unit employs less than 50 to 100 workers with/without power then it would not require a license from the Government of India even for the six product groups covered in licensing (under Schedule II of the notification). Subject to this minor limitation, an entrepreneur can set up a SSI unit anywhere in the country without any restriction. The units are, of course, subject to the locational/land use and zoning restrictions in force under the local laws (Development Commissioner, Ministry on MSMEs, Government of India).

Further, item groups reserved for exclusive manufacture by micro and small enterprises, as per the Gazette notification include: food and allied industries, wood and wood products, paper products, injection moulding thermo-plastic products, chemicals and chemical products, glass and ceramics, and mechanical engineering products excluding transport equipment (Anand G, 2009).

Major Incentives to Small Scale Industries that Deserves Special Mention

Some of the major incentives to small scale industries in India that deserves special mention are as follows:

An incentive is a motivational factor which induces a person to work hard or to do his work more efficiently. Many incentives are provided both by the Central and State Governments to promote the growth of small-scale industries and also to protect them from the onslaught of the large-scale sector. Among the various incentives given to small-scale industries the following deserve special mention:

1. Reservation: - To protect the small-scale industries from the competition posed by large-scale industries, the Government has reserved the production of certain items exclusively for the small-scale sector. The number of items exclusively re-served for the small-scale sector has been considerably increased during the Five Year Plan Periods and now stands at 822. However, prior to the 1997 – 98 Budget the number of items reserved for the small-scale sector stood at 836. The Finance Minister deferred 14 items in the 1997 – 98 Budget.

2. Preference in Government purchases: - The Government as well as Government organisations shows preference in procuring their requirements from the small-scale sector. For instance, the Director General of Supplies and Disposals purchases 400 items exclusively from the small-scale sector. The National Small-Scale Industries Corporation assists the SSI units in obtaining a greater share of Government and defence purchases.

3. Price preference: - The SSI units are given price preference up to a maximum of 15 per cent in respect of certain items purchased both from small-scale and large-scale units.

4. Supply of raw materials: - In order to ensure regular supply of raw materials, imported components and equipment’s, the Government gives priority allocation to the small-scale sector as compared to the large-scale sector. Further, the Government has liberalised the import policy and streamlined the distribution of scarce raw materials.

5. Excise duty: - In respect of SSI units excise duty concessions are granted to both registered and unregistered units on a graded scale depending upon their production value. Full exemption is granted up to a production value of Rs.30 lakhs in a year and 75 % of normal duty is levied for production value exceeding Rs.30 lakhs but not exceeding Rs.75 lakhs. If the production value exceeds Rs.75 lakhs, normal rate of duty will be levied.

6. RBI’s credit guarantee scheme: - In 1960, the RBI introduced a Credit Guarantee Scheme for small-scale industries. As per the Scheme, the RBI takes upon itself the role of a guarantee organisation for the advances which are left unpaid, including interest overdue and...
recovered charges. This scheme covers not only working capital but also advances provided for the creation of fixed capital.

7. Financial assistance: Small-scale industries are brought under the priority sector. As a result, financial assistance is provided to SSI units at concessional terms by commercial banks and other financial institutions. With a view to providing more financial assistance to the small-scale sector, several schemes have been introduced in the recent past the Small Industries Development Fund (SIDF) in 1986, National Equity Fund (NEF) in 1987 and the Single Window Scheme (SWS) in 1988.

SIDF provides refinance assistance to small-scale and cottage and village industries and the tiny sector in rural areas. NEF provides equity type support to small entrepreneurs for setting up new projects in the tiny/small-scale sector. In 1996, the small-scale sector received 42.3 per cent of the total priority sector advances from public sector banks.

8. Technical consultancy services: The Small Industries Development Organisation, through its network of service and branch institutes, provides technical consultancy services to SSI units. In order to provide the necessary technical input to rural industries, a Council for Advancement of Rural Technology was set up in October, 1982. The Technical Consultancy Organisation renders consultancy services to SSI units at a subsidised rate. Many financial institutions are also providing subsidies to SSI units for availing of consultancy services. For instance, small entrepreneurs proposing to set up rural, cottage, tiny or small-scale units, can get consultancy services at a low cost from the Technical Consultancy Organisations approved by the All-India and State-level financial institutions.

They have to pay only 20% of the fees charged by a technical consultancy organisation. The entire balance of 80% or Rs.5,000 whichever is lower is subsidised by the Industrial Finance Corporation of India.

9. Machinery on hire purchase basis: The National Small Industries Corporation (NSIC) arranges supply of machinery on hire purchase basis to SSI units, including ancillaries located in backward areas which qualify for investment subsidy. The rate of interest charged in respect of technically qualified persons and entrepreneurs coming from backward areas is less than the amount charged to others. The earnest money payable by technically qualified persons and entrepreneurs from backward areas is 10% as against 15% in other cases.

10. Transport subsidy: The Transport Subsidy Scheme, 1971 envisages grant of a transport subsidy to small-scale units in selected areas to the extent of 75% of the transport cost of raw materials which are brought into and finished goods which are taken out of the selected areas.

11. Training facilities: The Entrepreneurship Development Institute of India, financial institutions, commercial banks, technical consultancy organisations, and NSIC provide training to existing and potential entrepreneurs.

12. Marketing assistance: The National Small Industries Corporation (NSIC), the Small Industries Development Organisation (SIDO) and the various Export Promotion Councils help SSI units in marketing their products in the domestic as well as foreign markets. The SIDO conducts training programmes on export marketing and organises meetings and seminars on export promotion.

13. District Industries Centres (DICs): The 1977 Industrial Policy Statement introduced the concept of DICs. Accordingly a DIC is set up in each district. The DIC provides and arranges a package of assistance and facilities for credit guidance, supply of raw materials, marketing etc.

Tax Benefits available to Small-Scale Industries in India

Some of the tax benefits available to Small-Scale Industries in India are as follows:

Tax Holiday:
Under section 80J of the Income Tax Act 1961, new industrial undertakings, including small-scale industries, are exempted from the payment of income-tax on their profits subject to a maximum of 6% per annum of their capital employed. This exemption in tax is allowed for a period of five years from the commencement of production.

A small-scale industry has to satisfy the following two conditions to avail of this tax exemption facility:
1. The unit should not have been formed by the splitting or reconstruction of an existing unit.
2. The unit should employ 10 or more workers in a manufacturing process with the power or at least 20 workers without power.

Depreciation:
Under Section 32 of the Income Tax Act, 1961, a small-scale industry is entitled to a deduction on deprecation account on block of assets at the prescribed rate. Small enterprise is allowed subject to a maximum of Rs. 20 lakh deduction for depreciation on plant and machinery on the diminishing balance method.

In case of an asset acquired before the accounting period, depreciation is calculated on its written down value. For plant and machinery that are used in manufacturing in double or triple shift, an additional allowance called ‘Extra Shift Allowance’ is also available.

A small-scale industry should satisfy the following conditions before it becomes eligible for deduction in depreciation:
1. The assets must be owned by the assessee.
2. The assets must actually be used for the purpose of the assessee’s business or profession.
3. Depreciations allowance or deduction is allowed only on fixed assets, i.e. building machinery, plant and furniture.

From assessment year 1991-92, in the case of a company, depreciation will be limited to Rs. 7,590/- of the amount calculated at the specified percentage on the written down value block of assets.

Rehabilitation Allowance:
A rehabilitation allowance is granted to small-scale industries under Section 33-B of the Income Tax Act, 1961 whose business is discontinued on account of the following reasons:
1. Flood, typhoon, hurricane, cyclone; 2. Riot or civil disturbance; 3. Earthquake, or other natural upheavals; 4. Accidental fire or explosion; and 5. Action by an enemy or action taken in combating an enemy.

The rehabilitation allowance should be used for business purposes within three years of unit’s re-establishment, reconstruction, or revival. The rehabilitation allowance is allowed to the unit equivalent of 60 per cent of the amount of the deduction allowable to the unit.

Investment Allowance:
The Investment allowance was introduced way back in 1976 to replace the initial depreciation allowance. The investment allowance is allowed to the unit equivalent of 60 per cent of the amount of the deduction allowable to the unit.

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

Expenditure on Scientific Research:
Under Section 35 of the Income Tax Act, 1961, the following deductions in respect of expenditure on scientific research are allowed:
1. Any revenue expenditure incurred on scientific research related to the business of the assessee in the previous year.
2. Any sum paid to a scientific research association or a university, college, institution or to a public company which has its object, the undertaking of a scientific research.
3. Any capital expenditure incurred on scientific research related to the business of the assessee subject to the provision of Section 35(2) of the Income Tax Act, 1961.

Amortization of Certain Preliminary Expenses:
The Indian companies and resident persons, under Section 35D of the Income Tax Act 1961, are allowed to write off the preliminary and developmental expenses incurred by them in connection with the setting up of a new industrial unit or expansion of an existing industrial unit.

The examples of preliminary expenses are:

a. Expenses incurred in connection with the preparation of a feasibility report necessary for their business;
b. Engineering expenses related to the business; and
c. Legal charges, if any, for drafting agreements.

The writing off of the preliminary expenses is allowed against subject to a maximum of ten annual installments beginning with the previous year in which the new unit commences its production or expansion of an existing unit is completed. The aggregate amount of expenditure allowed be deducted is limited to 2.5 per cent of the total cost of the project.

A small-scale unit established in a backward area, under Section 80-HH, is allowed a deduction of 20 per cent on its profits and gains provided the unit satisfies the following conditions:

1. The unit began its production after 31st December 1970 in any backward area of the country;
2. It is a newly established unit in a backward area. It is neither split nor reconstituted out of a business already in existence in any backward area;
3. It has not been formed by the transfer to a new business of machinery or plant which was previously used for any purpose in any backward area; and
d. It employs 10 or more workers in a manufacturing process with power or 20 or more workers without power.

Tax Concession to Small-Scale Industries in Rural Areas:
The Finance (No.2) Act of 1977 inserted a new Section 80-HHA in the Income Tax Act, 1961. The tax payers, under this Section 80-HHA, are entitled to a deduction of 20% of the profits and gains derived by running small-scale industries in the rural areas.

The deduction is allowed for a period of 10 years from the year of commencement of manufacturing activity after 30th September 1977. For this purpose, the expression rural area means any area as defined under the Explanation to Section 35 CC (I) of the Income Tax Act, 1961. However, this tax deduction benefit is not allowed to the small-scale units engaged in mining activity.

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

1. The small-scale unit is not formed by splitting or reconstruction of a business already in existence.
2. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.
3. The accounts of the unit are audited by a chartered accountant.
4. It employs 10 or more workers in manufacturing process carried on without the aid of power.

Tax Concessions to Small-Scale Industries in Backward Areas:
The Planning Commission of India, in 1970-71, declared 247 districts out of 435 districts as backward areas with a view to provide them special incentives and concessions to establish industries in these backward areas. The newly established small-scale industries in these areas specified in the Eighth Schedule to the Income Tax Act, 1961 are entitled to a deduction of 20% of their profits and gains from their gross total income.

This deduction is allowed for a period of 10 years beginning with the year of commencement of manufacture or production. However, if a small-scale industry has already been established in a non-backward area and later shifted to backward area, the unit will be allowed this deduction on the profits earned from the undertaking after shifting in the backward area for a period of 10 years. A small-scale industry established in backward area but engaged in mining activity is not entitled to such deduction benefit.

The unit has to satisfy the following conditions to be eligible to avail of this tax benefit:
1. It is established on or after 31st December, 1970.
2. It employs at least 10 workers in manufacturing process carried on with the aid of power or at least 20 workers manufacturing process carried on without the aid of power.

Expenditure on Acquisition of Patents and Copyrights:
Under Section 35-A of the Income Tax Act, 1961, any expenditure of capital nature incurred in acquiring a patent and copyright by a small-scale industry is deductible from its income. But the expenditure should be incurred after 28th February 1966. The expenditure can be deducted in 14 equal installments beginning with the previous year in which the expenditure was incurred in acquiring patents and copyrights for the unit.

Profit from Business of Publication of Books:
Under Section 80-1A of the Income Tax Act, 1961 which has replaced Section 80-1 w.e.f. the assessment year 1991-92, 20% of the profits earned by a small-scale industry from the business of publication of books is deductible from its gross total income. The deduction benefit is available for total period of five years beginning with the assessment year 1992-93.

In addition, deductions are also available in respect of:
Factors Affecting Site Location of an Industrial Unit: Site Selection

Decision with regard to location of an industrial unit involves a careful study of many factors. Proper and right choice of location is instrumental in future success of the business. The various factors are divided into two categories viz., ‘primary factors’ and ‘secondary factors’. These factors are explained as follows:

(i) Primary Factors:

(A) Availability of Raw Materials:

Raw material form major proportion of the finished product. Unrestricted and regular supply of raw material is very necessary for carrying out unrestricted production. Nearness to the source of raw material is very economical for an industrial unit. On account of this consideration many industries have been set up near the source of supply of raw material. Sugar factories in Uttar Pradesh, Textile units in Maharashtra and Gujarat, Cement factories in Madhya Pradesh and Jute industry in West-Bengal. Nearness to raw material is important in case of heavy and bulky materials having lesser value such as coal and other weight losing materials. Raw materials can be divided into three:

(a) raw materials which are weight losing and cannot be preserved for a long time e.g., fruits for juice making
(b) raw materials which are bulky, heavy and weight losing in nature, like iron ore etc.
(c) raw materials which are not heavy and can be preserved for a longer period of time, e.g., raw cotton.

Industry using third type of raw material can be located anywhere. Alford Weber has given another type of raw materials called ubiquitous like clay sand and water which are found everywhere and as such do not affect the location of an industry.

Another important point to be kept in mind that only nearness of raw materials is not sufficient; it must also be easily accessible. Adequate transportation facilities should be available for carrying the material from the source of supply. A guiding principle should be followed in this regard i.e., “higher the proposition of the cost of raw materials to the total cost, the greater is the possibility of choosing a site near the source of raw materials.”

(B) Availability of labour:

Labour cost is one of the main constituents of the total cost of production. It influences the total cost of production. Labour implies both the skilled and unskilled workers needed for different types of activities. The supply of un-skilled labour does not create any serious problem because such labour is available everywhere. Skilled labour is available only at specific centres.

Industries requiring highly skilled labour have to select such sites which ensure adequate and regular supply of required labour. Availability of skilled and efficient labour is mainly responsible for the development of various industries in a particular region e.g., cotton textile industry of Great Britain developed at Lancashire mainly on account of availability efficient labour.

On account of mobility of labour, this factor does not materially affect the location of an industrial unit. The labour can be attracted by providing various facilities and incentives like housing, canteen, rest rooms, incentive wage plans etc.

In actual practice, if required skilled labour is not available in a particular region, the available labour can be trained in the required skill or alternatively skilled and trained labour can be migrated from other regions to the plant. But both these methods are time consuming and involve lot of expenditure which ultimately increase the cost of production.

(C) Availability of Power and Fuel:

Availability of cheap power and fuel supply sources is another decisive factor in selecting proper location of an industrial unit. In the past, coal was the main sources of power supply for various types of heavy and large scale industries like iron and steel, cement and aluminium etc., the industrial units which used to be located near coal supplying centres.

But at present, there are several other sources of power, e.g., electricity, gas, oil and water power etc. On account of these various alternative sources of power supply, coal, as a main source of power is getting lesser recognition. Rapid development of hydro-electric power has provided wider choice for location of industrial units even at far flung and remote areas. Modern industrialisation could not have been possible without the growth of hydroelectric generating units.

(D) Availability of Transport and Communication facilities:

Adequate and quick facilities of transport must be kept in mind for quick delivery of raw materials to the factory and finished products to the market. Kimball and Kimball have rightly pointed out that “The ideal plant is one centrally located and directly served by water, rail, trucking and air facilities”.

In certain type of industries transportation is the sole factor which is taken into consideration in deciding location of an industrial unit. For example, a cement factory is always situated near the source of lime stone which is carried usually with the help of trolleys to the factory. Transportation is the life line of modern industry. The basic aim of selecting a particular mode of transportation should be minimum transportation cost with maximum transportation service. An industry should be located in the areas where there are already developed means of transportation.

Faridabad in Haryana developed as an industrial town on account of availability of both rail and road transportation. Phagwara serves another very good example of this type. Certain port towns like Calcutta, Bombay and Madras have attained significant importance on account of availability of excellent water and rail transportation facilities.

In modern times different modes of transportation and their increased efficiency and flexibility have provided ample choice to the industrialists in the matter of location. Besides transportation, communication services are also used to be of immense importance in deciding the location of an industrial unit. A businessman needs regular information with regard to changes in the price of raw materials and finished products and other valuable information. On account of development of internet, mobile phones etc., this factor does not affect the location of plant now a days.

(v) Nearness to Market:

Market greatly affects the establishment of an industrial unit and is in fact, dominant factor in locating an industrial unit in modern times. The production of goods is undertaken with the aim of selling them quickly which is possible only on account of nearness to market.
Industries using pure raw material (which do not lose their weight when turned into finished products) may be situated away from the source of such raw materials. For example, wool is primarily produced in Australia, but woollen hosiery is found throughout the world. On the other hand, market as a factor of location will not affect much the location of industries using heavy and weight losing raw material. For example, iron and textile units are situated near the coal supplying centres. Similarly sugar factories are located very near the sources of raw materials. Nearness to market is important in case of industries producing consumer goods rather producers' goods, this is because production of consumer goods require constant adjustment of manufacturing programme on account of quick changes in the tastes, preferences and buying habits of the consumers. Markets may be national or regional. In case where the demand of the product is on regional basis, the factory is usually situated near the major market for the product. For example, a publishing house publishing Punjabi books cannot be located in Calcutta or Bombay. Its ideal location would be Jalandhar, which is a leading publishing centre in Punjab.

(2) Secondary Factors:
Besides the above primary factors, there are some other factors which have bearing on the location of industries. Following factors can be explained under this category:

(i) Nearness to adequate Banking and credit facilities:
For the efficient and smooth running of the business and for meeting working capital requirements, banking facilities play an important role. Nearness to banks and other financial institutions is an important consideration now-a-days in deciding location of an industrial unit. This is because banking has become indispensable part of modern business. In case of rural and small scale industries, banks and financial institutions play an important role and provide invaluable service in order to cater their financial needs.

(ii) Facilities of Repairs:
In order to maintain uninterrupted production, facilities with regard to repairs of machinery, plant and other components (in case of breakdown), must be kept in mind before setting a factory. A large scale concern can afford to install its own repair workshops, whereas small concerns may rely on various repair shops working near the factory.

(iii) Fire fighting facilities:
In order to protect the factory against the risk of fire, adequate fire fighting facilities must be provided. Internal arrangements pertaining to fire extinguishers, sand buckets and other firefighting equipment must be arranged. In case there arises the necessity of calling fire brigades, proper preparations must be made for the same.

(iv) Soil, Climate and Topography of a place:
Soil and climatic conditions are very important for the establishment of various type of industries like tea, coffee, rubber and tobacco. On account of this factor, jute industry developed in West- Bengal and tea industry in Assam. Similarly topography (e.g., hilly or rocky surface) of a place also influences location of an industry. Areas which are frequently subjected to earthquakes and other natural calamities may not attract many industries. Climate of a place also considerably affects the efficiency of workers. Efficient workers are found in cool climatic regions. On the other hand workers from tropical regions are not generally so efficient. This also affects the establishment of an industrial unit.

Another important point in this regard is that means of transportation and communication are more in plains rather than in hilly areas. That is why industries have developed largely in plains rather than in hilly areas.

(v) Govt, policies and regulations:
Industrial Development and Regulation Act of 1951 laid down clearly certain rules, regulations and formalities to be complied before setting up an industrial unit. Prior permission and licence is necessary under the Act before the setting up of a new industrial unit. Certain cash incentives and concessions are also given by Govt, in order to promote a particular industry in a particular region. A careful thought to all these rules, regulations and provisions of Act must be given before the establishment of an industrial unit. In order to develop industries on sound lines, Govt, has declared certain areas as industrially backward or special economic zones. Certain concession and subsidies like cheap land, power and tax concession and subsidised raw materials etc., are provided in order to develop that particular area. Such measures are undertaken by the Govt, in order to ensure balanced and regional growth of industries in India.

(vi) Momentum of an early start:
This is another important factor affecting industrial location. A few industries start at a place and gradually other similar type of industries start at that particular place. For example, at Manimajra (a small town near Chandigarh) a few small automobile spare parts shops started about two decades back, but now a fully fledged automobile market has developed in that area. Similarly, at Ludhiana a few hosiery units started in the beginning, now Ludhiana has become a very big hosiery articles producing centre in India. Carpet industry developed gradually at Mirzapur district of Uttar Pradesh. There are various reasons responsible for such a concentration of industries in a particular region viz., (i) availability of required type of labour in a particular region, (ii) facilities of repairs and maintenance on account of many repair shops and workshops operating in the areas, (iii) Availability of transport, communication, banking and insurance facilities, (iv) Facilities of managerial consultations and advice are also available.

(vii) Industrial atmosphere:
This factor refers to the thinking of the people with regard to a particular industry in a particular area. They involve themselves completely in the intricacies and various operations of the machines and implements being used in the industry. There is a complete industrial atmosphere. Carpet industry at Bhadohi and Mirzapur serves a very good example of this kind. Major population of these cities is engaged in carpet processing, carpet washing, carpet weaving and carpet finishing. Not only men, but women and children have also engaged themselves in this industry directly or indirectly. Similarly, at Bombay film industry has developed. It is easier and cheaper to produce a film in Bombay than in any other part of the country.

(viii) Personal factors:
Sometimes personal likes had dislikes also influence location of a particular industrial unit. Henry Ford started manufacturing motor cars in Detroit because he belonged to that place. Certain merchants belonging to Ahmedabad have made that place a leading textile centre of India. But such personal likes and dislikes cannot influence location of an industrial unit in the long run.

(xl) Tastes and preferences of people: 
Before establishing an industrial unit in a particular region, buying habits, tastes, likes and dislikes of people in that area must be taken into consideration. Purchasing power of the people and composition of population in that region should be carefully studied. These studies and surveys render valuable information which is greatly helpful in establishing and industrial unit in particular region.

(x) Political and economic situation:
Political harmony and peace in a particular region encourage the establishment of industrial units. On the other hand, disturbed political and economic set up discourages the growth of industries in the region.

On account of Naxalites movement in West Bengal, Industries started moving out of West Bengal. Similarly is the case in certain other states where, on account of political disturbances, manufacturers have started thinking to settle elsewhere and further industrial expansion has been greatly affected.

(xi) Possibilities of future expansion:
The area for location should be such as to provide all possible opportunities for future development and expansion of the industrial unit without involving extra cost. Every industrial undertaking is established with the aim to expand in future.

(xii) Existence of competitive industries:
Limited and healthy competition encourages the growth of industrial units in a particular region. On the other hand, unhealthy competition retards the industrial growth in a region.

(xiii) Availability of research facilities:
The main aim of any industrial undertaking is to have maximum production with minimum cost. Constant research and experimentation is undertaken to develop products and improved methods of production.

Large concerns can afford to have a separate research department to meet this end, but in case of small and medium industrial units such facilities may be provided by specialised scientific and research institutions. Existence of such specialised institutions must be kept in mind before starting an industrial unit.

PLANT LOCATION
Every entrepreneur is faced with the problem of deciding the best site for location of his plant or factory.

What is plant location?
Plant location refers to the choice of region and the selection of a particular site for setting up a business or factory. But the choice is made only after considering cost and benefits of different alternative sites. It is a strategic decision that cannot be changed once taken. If at all changed only at considerable loss, the location should be selected as per its own requirements and circumstances. Each individual plant is a case in itself. Businessman should try to make an attempt for optimum or ideal location.

What is an ideal location?
An ideal location is one where the cost of the product is kept to minimum, with a large market share, the least risk and the maximum social gain. It is the place of maximum net advantage or which gives lowest unit cost of production and distribution. For achieving this objective, small-scale entrepreneur can make use of locational analysis for this purpose.

LOCATIONAL ANALYSIS
Locational analysis is a dynamic process where entrepreneur analyses and compares the appropriateness or otherwise of alternative sites with the aim of selecting the best site for a given enterprise. It consists the following:

(a) Demographic Analysis: It involves study of population in the area in terms of total population (in no.), age composition, per capita income, educational level, occupational structure etc.

(b) Trade Area Analysis: It is an analysis of the geographic area that provides continued clientele to the firm. He would also see the feasibility of accessing the trade area from alternative sites.

(c) Competitive Analysis: It helps to judge the nature, location, size and quality of competition in a given trade area.

(d) Traffic analysis: To have a rough idea about the number of potential customers passing by the proposed site during the working hours of the shop, the traffic analysis aims at judging the alternative sites in terms of pedestrian and vehicular traffic passing a site.

(e) Site economics: Alternative sites are evaluated in terms of establishment costs and operational costs under this. Costs of establishment is basically cost incurred for permanent physical facilities but operational costs are incurred for running business on day to day basis, they are also called as running costs.

SELECTION CRITERIA
The important considerations for selecting a suitable location are given as follows:

a) Natural or climatic conditions.
b) Availability and nearness to the sources of raw material.
c) Transport costs-in obtaining raw material and also distribution or marketing finished products to the ultimate users.
d) Access to market: small businesses in retail or wholesale or services should be located within the vicinity of densely populated areas.
e) Availability of Infrastructural facilities such as developed industrial sheds or sites, link roads, nearness to railway stations, airports or sea ports, availability of electricity, water, public utilities, civil amenities and means of communication are important, especially for small scale businesses.
f) Availability of skilled and non-skilled labour and technically qualified and trained managers.
g) Banking and financial institutions are located nearby.
h) Locations with links: to develop industrial areas or business centers result in maximum net advantage or which gives lowest unit cost of production and distribution. For achieving this objective, small-scale entrepreneur can make use of locational analysis for this purpose.
i) Strategic considerations of safety and security should be given due importance.
j) Government influences: Both positive and negative incentives to motivate an entrepreneur to choose a particular location are made available. Positive includes cheap overhead facilities like electricity, banking transport, tax relief, subsidies and liberalization. Negative incentives are in form of restrictions for setting up industries in urban areas for reasons of pollution control and decentralization of industries.
k) Residence of small businesses entrepreneurs want to set up nearby their homelands

One study of locational considerations from small-scale units revealed that the native place or homelands of the entrepreneur was the most important factor. Heavy preference to homeland suggests that small-scale enterprise is not freely mobile. Low preference for Government incentives suggests that concessions and incentives cannot compensate for poor infrastructure.
PLANT LAYOUT

The efficiency of production depends on how well the various machines; production facilities and employee’s amenities are located in a plant. Only the properly laid out plant can ensure the smooth and rapid movement of material, from the raw material stage to the end product stage. Plant layout encompasses new layout as well as improvement in the existing layout. It may be defined as a technique of locating machines, processes and plant services within the factory so as to achieve the right quantity and quality of output at the lowest possible cost of manufacturing. It involves a judicious arrangement of production facilities so that workflow is direct.

DEFINITION
A plant layout can be defined as follows:
Plant layout refers to the arrangement of physical facilities such as machinery, equipment, furniture etc. within the factory building in such a manner so as to have quickest flow of material at the lowest cost and with the least amount of handling in processing the product from the receipt of material to the shipment of the finished product.

Under this, machines and equipment are installed in the plants, which follow the workflow is direct. In this type of layout machines of a similar type are arranged together at one place. (b) Process layout

IMPORTANCE
Plant layout is an important decision as it represents long-term commitment. An ideal plant layout should provide the optimum relationship among output, floor area and manufacturing process. It facilitates the production process, minimizes material handling, time and cost, and allows flexibility of operations, easy production flow, makes economic use of the building, promotes effective utilization of manpower, and provides for employee’s convenience, safety, comfort at work, maximum exposure to natural light and ventilation. It is also important because it affects the flow of material and processes, labour efficiency, supervision and control, use of space and expansion possibilities etc.

ESSENTIALS
An efficient plant layout is one that can be instrumental in achieving the following objectives:

a) Proper and efficient utilization of available floor space
b) To ensure that work proceeds from one point to another point without any delay
c) Provide enough production capacity.
d) Reduce material handling costs

TYPES OF LAYOUT

From the point of view of plant layout, we can classify small business or unit into three categories:

1. Manufacturing units
2. Traders
3. Service Establishments

1. Manufacturing units
(a) Product or line layout
(b) Process or functional layout
(c) Fixed position or location layout
(d) Combined or group layout

Under this, machines and equipment’s are arranged in one line depending upon the sequence of operations required for the product. The materials move form one workstation to another sequentially without any backtracking or deviation. Under this, machines are grouped in one sequence. Therefore materials are fed into the first machine and finished goods travel automatically from machine to machine, the output of one machine becoming input of the next, e.g. in a paper mill, bamboo are fed into the machine at one end and paper comes out at the other end. The raw material moves very fast from one workstation to other stations with a minimum work in progress storage and material handling. The grouping of machines should be done keeping in mind the following general principles.

a) All the machine tools or other items of equipments must be placed at the point demanded by the sequence of operations
b) There should no points where one line crossed another line.
c) Materials may be fed where they are required for assembly but not necessarily at one point.
d) All the operations including assembly, testing packing must be included in the line.

Advantages: Product layout provides the following benefits:
(a) Low cost of material handling, due to straight and short route and absence of backtracking and inventory in work in process
(b) Smooth and uninterrupted operations
(c) Continuous flow of work
(d) Lesser investment in machinery
(e) Optimum use of floor space
(f) Shorter processing time or quicker output

Disadvantages: Product layout suffers from following drawbacks:
(a) High initial capital investment in special purpose machine
(b) Heavy overhead charges

Suitability: Product layout is useful under following conditions:
1) Mass production of standardized products
2) Simple and repetitive manufacturing process
3) Operation time for different process is more or less equal

(b) Process layout:

In this type of layout machines of a similar type are arranged together at one place. E.g. Machines performing drilling operations are arranged in the drilling department, machines performing casting operations are grouped in the casting department. Therefore the machines are installed in the plants, which follow the process layout.

A line layout for two products is given below.

<table>
<thead>
<tr>
<th>Product A</th>
<th>Product B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lathe</td>
<td>Planer</td>
</tr>
<tr>
<td>Drill</td>
<td>Grinder</td>
</tr>
<tr>
<td>Grider</td>
<td>Miler</td>
</tr>
<tr>
<td>Assembly</td>
<td>Lathe</td>
</tr>
<tr>
<td>Paint shop</td>
<td>Welding</td>
</tr>
</tbody>
</table>

- g) Less congestion of work in the process
- h) Simple and effective inspection of work and simplified production control
- i) Lower cost of manufacturing per unit
- j) Provide ease of supervision and control
- k) Provide for employee safety and health
- l) Allow ease of maintenance
- m) Allow high machine or equipment utilization
- n) Improve productivity
- o) Provide volume and product flexibility
- p) Provide for volume and product flexibility
- q) Increase employee morale
- r) Reduce accidents
- s) Reduce material handling costs
- t) Utilise labour efficiently
- u) Reduce hazards to personnel
- v) Provide employee safety and health
- w) Provide for employee safety and health
- x) Provide employee safety and health
- y) Provide employee safety and health
- z) Provide employee safety and health

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Don't Forget Like And Comment
Thanks
Hence, such layouts typically have drilling department, milling department, welding department, heating department and painting department etc. The process or functional layout is followed from historical period. It evolved from the handicraft method of production.

The work has to be allocated to each department in such a way that no machines are chosen to do as many different job as possible i.e. the emphasis is on general purpose machine.

The work, which has to be done, is allocated to the machines according to loading schedules with the object of ensuring that each machine is fully loaded. Process layout is shown in the following diagram.

The grouping of machines according to the process has to be done keeping in mind the following principles
(a) The distance between departments should be as short as possible for avoiding long distance movement of materials
(b) The departments should be in sequence of operations
(c) The arrangement should be convenient for inspection and supervision

Advantages: Process layout provides the following benefits
(a) Lower initial capital investment in machines and equipments. There is high degree of machine utilization, as a machine is not blocked for a single product
(b) The overhead costs are relatively low
(c) Change in output design and volume can be more easily adapted to the output of variety of products
(d) Breakdown of one machine does not result in complete work stoppage
(e) Supervision can be more effective and specialized

Disadvantages: Process layout suffers from following drawbacks
(a) Material handling costs are high due to backtracking
(b) More skilled labour is required resulting in higher cost.
(c) Time gap or lag in production is higher

Suitability: Process layout is adopted when
1. Products are not standardized
2. Quantity produced is small
3. There are frequent changes in design and style of product
4. Job shop type of work is done
5. Machines are very expensive

Thus, process layout or functional layout is suitable for job order production involving non-repetitive processes and customer specifications and nonstandardized products, e.g. tailoring, light and heavy engineering products, made to order furniture industries, jewelry.

(c) Fixed Position or Location Layout

In this type of layout, the major product being produced is fixed at one location. Equipment labour and components are moved to that location. All facilities are brought and arranged around one work center. This type of layout is not relevant for small scale entrepreneur.

The following figure shows a fixed position layout regarding shipbuilding.

Advantages: Fixed position layout provides the following benefits
(a) It saves time and cost involved on the movement of work from one workstation to another.
(b) The layout is flexible as change in job design and operation sequence can be easily incorporated.
(c) It is more economical when several orders in different stages of progress are being executed simultaneously.
(d) Adjustments can be made to meet shortage of materials or absence of workers by changing the sequence of operations.

Disadvantages: Fixed position layout has the following drawbacks
(a) Production period being very long, capital investment is very heavy
(b) Very large space is required for storage of material and equipment near the product.
(c) As several operations are often carried out simultaneously, there is possibility of confusion and conflicts among different workgroups.

Suitability: The fixed position layout is followed in following conditions
1. Manufacture of bulky and heavy products such as locomotives, ships, boilers, generators, wagon building, aircraft manufacturing, etc.
2. Construction of building, flyovers, dams. 3. Hospital, the medicines, doctors and nurses are taken to the patient (product).

(d) Combined layout

Certain manufacturing units may require all three processes namely intermittent process (job shops), the continuous process (mass production shops) and the representative process combined process [i.e. miscellaneous shops]. In most of industries, only a product layout or process layout or fixed location layout does not exist. Thus, in manufacturing concerns where several products are produced in repeated numbers with no likelihood of continuous production, combined layout is followed. Generally, a combination of the product and process layout or other combination are found, in practice, e.g. for industries involving the fabrication of parts and assembly, fabrication tends to employ the process layout, while the assembly areas often employ the product layout. In soap, manufacturing plant, the machinery manufacturing soap is arranged on the product line principle, but ancillary services such as heating, the manufacturing of glycerin, the power house, the water treatment plant etc. are arranged on a functional basis.

2. Traders
When two outlets carry almost same merchandise, customers usually buy in the one that is more appealing to them. Thus, customers are attracted and kept by good layout i.e. good lighting, attractive colours, good ventilation, air conditioning, modern design and arrangement and even music. All of these things mean customer convenience, customer appeal and greater business volume.

The customer is always impressed by service, efficiency and quality. Hence, the layout is essential for handling merchandise, which is arranged as per the space available and the type and magnitude of goods to be sold keeping in mind the convenience of customers. There are three kinds of layouts in retail operations today.

1. Self-service or modified self-service layout  2. Full service layout  3. Special layouts
The self-service layouts, cuts down on sales clerk’s time and allow customers to select merchandise for themselves. Customers should be led through the store in a way that will expose them to as much display area as possible, e.g. Grocery Stores or department stores. In those stores, necessities or convenience goods should be placed at the rear of the store. The use of color and lighting is very important to direct attention to interior displays and to make the most of the stores layout.

All operations are not self-service. Certain specialty enterprises sell to fewer numbers of customers or higher priced product, e.g. Apparel, office machines, sporting goods, fashion items, hardware, good quality shoes, jewelry, luggage and accessories, furniture and appliances are all examples of products that require time and personal attention to be sold. These full service layouts provide area and equipment necessary in such cases.

Some layouts depend strictly on the type of special store to be set up, e.g. TV repair shop, soft ice cream store, and drive-in soft drink stores are all examples of business requiring special design. Thus, good retail layout should be the one, which saves rent, time and labour.

3. Services centers and establishment

Services establishments such as motels, hotels, restaurants, must give due attention to client convenience, quality of service, efficiency in delivering services and pleasing office ambience. In today’s environment, the clients look for ease in approaching different departments of a service organization and hence the layout should be designed in a fashion, which allows clients quick and convenient access to the facilities offered by a service establishment.

FACTORS INFLUENCING LAYOUT

While deciding his factory or unit or establishment or store, a small-scale businessman should keep the following factors in mind:

a) Factory building: The nature and size of the building determines the floor space available for layout. While designing the special requirements, e.g. air conditioning, dust control, humidity control etc. must be kept in mind.

b) Nature of product: product layout is suitable for uniform products whereas process layout is more appropriate for custom-made products.

c) Production process: In assembly line industries, product layout is better. In job order or intermittent manufacturing on the other hand, process layout is desirable.

d) Type of machinery: General purpose machines are often arranged as per process layout while special purpose machines are arranged according to product layout

e) Repairs and maintenance: machines should be so arranged that adequate space is available between them for movement of equipment and people required for repairing the machines.

f) Human needs: Adequate arrangement should be made for cloakroom, washroom, lockers, drinking water, toilets and other employee facilities, proper provision should be made for disposal of effluents, if any.

g) Plant environment: Heat, light, noise, ventilation and other aspects should be duly considered, e.g. paint shops and plating section should be located in another hall so that dangerous fumes can be removed through proper ventilation etc. Adequate safety arrangement should also be made.

DYNAMICS OF PLANT LAYOUT

Plant layout is a dynamic rather than a static concept meaning thereby if once done it is not permanent in nature rather improvement or revision in the existing plant layout must be made by keeping a track with development of new machines or equipment, improvements in manufacturing process, changes in materials handling devices etc. But, any revision in layout must be made only when the savings resulting from revision exceed the costs involved in such revision. Revision in plant layout may become necessary on account of the following reasons:

a) Increase in the output of the existing product

b) Introduction of a new product and diversification

c) Technological advancements in machinery, material, processes, product design, fuel etc.

d) Deficiencies in the layout unnoticed by the layout engineer in the beginning.

Production Planning and Control: Meaning, Characteristics and Objectives

Meaning:

Production planning and control is an important task of Production Manager. It has to see that production process is properly decided in advance and it is carried out as per the plan. Production is related to the conversion of raw materials into finished goods. This conversion process involves a number of steps such as deciding what to produce, how to produce, when to produce, etc. These decisions are a part, of production planning. Merely deciding about the task is not sufficient. The whole process should be carried out in a best possible way and at the lowest cost. Production Manager will have to see that the things proceed as per the plans. This is a control function and has to be carried as meticulously as planning. Both planning and control of production are necessary to produce better quality goods at reasonable prices and in a most systematic manner.

Production planning is the function of looking ahead, anticipating difficulties to be faced and the likely remedial steps to remove them. It may be said to be a technique of forecasting ahead every step in the long process of production, taking them at a right time and in the right degree and trying to complete the operations at maximum efficiency. Production control, on the other hand, guides and directs flow of production so that products are manufactured in a best way and conform to a planned schedule and are of the right quality. Control facilitates the task of manufacturing and see that everything goes as per the plans.

Goldon B. Carson:

“Production planning and control involves generally the organization and planning of the manufacturing process. Specifically, it consists of the planning of the routing, scheduling, dispatching and inspection, co-ordination and the control of materials, methods, machines, tooling and operating times. The ultimate objective is the organization of the supply and movement of materials and labour, machine utilization and related activities, in order to bring about the desired manufacturing results in terms of quantity, time and place.”

James L. Lundy:

“Basically, the production control function involves the co-ordination and integration of the factors of production for optimum efficiency. Overall sales orders or plans must be translated into specific schedules and assigned so as to occupy all work centres but overload none.
The job can be done formally in which case elaborate charting and filing techniques are used; or it can be done informally, with individuals' thoughts and retention there of supplanting tangible aids."

Charles A. Koepke:

"Production planning and control is the coordination of a series of functions according to a plan which will economically utilize the plant facilities and regulate the orderly movement of goods through the entire manufacturing cycle, from the procurement of all materials to the shipping of finished goods at a predetermined rate."

Characteristics of Production Planning and Control:
The foregoing discussion brings out the following traits of production planning and control:
1. It is the planning and control of manufacturing process in an enterprise. The questions like—What is to be manufactured? When is it to be manufactured? How to keep the schedule of production etc.? —are decided and acted upon for getting good results.
2. All types of inputs like materials, men, machines are efficiently used for maintaining efficiency of the manufacturing process.
3. Various factors of production are integrated to use them efficiently and economically.
4. The manufacturing process is organized in such a way that none of the work centres is either overworked or under worked. The division of work is undertaken very carefully so that every available element is properly utilized.
5. The work is regulated from the first stage of procuring raw materials to the stage of finished goods.

Objectives of Production Planning and Control:
Planning of production precedes control. Whatever is planned needs to be controlled. The ultimate objective of both planning and control is to use various inputs in an efficient way and to have a proper control over various targets and schedules fixed earlier.
The following details will bring out the objectives of production planning and production control:

Production Planning:
1. To determine the requirements for men, materials and equipment.
2. Production of various inputs at a right time and in right quantity.
3. Making most economical use of various inputs.
4. Arranging production schedules according to the needs of marketing department.
5. Providing for adequate stocks for meeting contingencies.
6. Keeping up-to-date information processes.

Production Control:
1. Making efforts to adhere to the production schedules.
2. Issuing necessary instructions to the staff for making the plans realistic.
3. To ensure that goods produced according to the prescribed standards and quality norms.
4. To ensure that various inputs are made available in right quantity and at proper time.
5. To ensure that work progresses according to the predecided plans.

Production Planning and Control
Introduction
For efficient, effective and economical operation in a manufacturing unit of an organization, it is essential to integrate the production planning and control system. Production planning and subsequent production control follow adaption of product design and finalization of a production process.
Production planning and control address a fundamental problem of low productivity, inventory management and resource utilization. Production planning is required for scheduling, dispatch, inspection, quality management, inventory management, supply management and equipment management. Production control ensures that production team can achieve required production target, optimum utilization of resources, quality management and cost savings.
Planning and control are an essential ingredient for success of an operation unit.
The benefits of production planning and control are as follows:
1. It ensures that optimum utilization of production capacity is achieved, by proper scheduling of the machine items which reduces the idle time as well as over use.
2. It ensures that inventory level are maintained at optimum levels at all time, i.e. there is no over-stocking or under-stocking.
3. It also ensures that production time is kept at optimum level and thereby increasing the turnover time.
4. Since it overlooks all aspects of production, quality of final product is always maintained.

Production Planning
Production planning is one part of production planning and control dealing with basic concepts of what to produce, when to produce, how much to produce, etc. It involves taking a long-term view at overall production planning.

Therefore, objectives of production planning are as follows:
1. To ensure right quantity and quality of raw material, equipment, etc. are available during times of production.
2. To ensure capacity utilization is in tune with forecast demand at all the time.

benefits:
1. Organization can deliver a product in a timely and regular manner.
2. Supplier are informed will in advance for the requirement of raw materials.
3. It reduces investment in inventory.
4. It reduces overall production cost by driving in efficiency.

Production planning takes care of two basic strategies' product planning and process planning. Production planning is done at three different time dependent levels i.e. long-range planning dealing with facility planning, capital investment, location planning, etc.; medium-range planning deals with demand forecast and capacity planning and lastly short term planning dealing with day to day operations.

Production Control
Production control looks to utilize different type of control techniques to achieve optimum performance out of the production system as to achieve overall production planning targets.

Therefore, objectives of production control are as follows:
1. Regulate inventory management
2. Organize the production schedules

The advantages of robust production control are as follows:
1. Ensure a smooth flow of all production processes
2. Ensure production cost savings thereby improving the bottom line
3. Optimum utilization of resources and production process
4. It maintains standard of quality through the production life cycle.

Production control cannot be same across all the organization.

Production planning and control are essential for customer delight and overall success of an organization.

Production Cost: Different Types of Costs of Production

Productivity and advances in technology both would be likely to reduce a firm’s average cost of production.

Total and Average Cost:
Total cost (TC), as its name implies, is the total cost of producing a given output. The more the output is produced, the higher the total cost of production. Producing more units requires the use of more resources. Average cost (AC) is also referred to as unit cost and is given as total cost divided by output. Table 1 shows the relationship between output, total cost and average cost.

### Table 1 Total and average cost.

<table>
<thead>
<tr>
<th>Output</th>
<th>Total cost ($)</th>
<th>Average cost ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>10</td>
<td>–</td>
</tr>
<tr>
<td>1</td>
<td>30</td>
<td>–</td>
</tr>
<tr>
<td>2</td>
<td>60</td>
<td>–</td>
</tr>
<tr>
<td>3</td>
<td>90</td>
<td>–</td>
</tr>
<tr>
<td>4</td>
<td>120</td>
<td>–</td>
</tr>
<tr>
<td>5</td>
<td>150</td>
<td>–</td>
</tr>
</tbody>
</table>

Fixed Costs:
Table 1 indicates that there is a cost even when output is zero. In the short run, some factors of production are in fixed supply. When a firm changes its output, the costs of these factors remain unchanged – they are fixed. For instance, if a firm raised its output, the interest it pays on past loans would remain unchanged.

If it closed Total fixed cost down during a holiday period, it may still have to pay for security and rent for buildings. Fig. 1 shows that total fixed cost (TFC) remains unchanged as output changes.

Fixed costs (FC) are also sometimes referred to as overheads or indirect costs.

Average Fixed Cost:
Average fixed cost (AFC) is total fixed cost divided by output. As fixed cost is constant, average fixed cost is divided by higher output. Table 2 and Fig. 2 show how average fixed cost falls as output increases.

### Table 2 Average fixed cost:

<table>
<thead>
<tr>
<th>Output</th>
<th>Total fixed cost ($)</th>
<th>Average fixed cost ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>10</td>
<td>–</td>
</tr>
<tr>
<td>1</td>
<td>10</td>
<td>10</td>
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<tr>
<td>2</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>10</td>
<td>3.33</td>
</tr>
<tr>
<td>4</td>
<td>10</td>
<td>2.5</td>
</tr>
<tr>
<td>5</td>
<td>10</td>
<td>2</td>
</tr>
</tbody>
</table>

Variable Costs:
Variable costs (VC), also sometimes called direct costs, are the costs of the variable factors. They vary directly as output changes. Production and sale of more cars will involve an increased expenditure on component parts, electricity, wages and transport for a car firm. As output increases, total variable cost rises. It usually tends to rise slowly at first and then rise more rapidly. This is because productivity often rises at first and then begins to decline after a certain output.

### Fig. 3 shows the change of total variable cost (TVC) with output:

<table>
<thead>
<tr>
<th>Total variable cost ($)</th>
<th>Average variable cost ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>70</td>
<td>35</td>
</tr>
<tr>
<td>90</td>
<td>30</td>
</tr>
<tr>
<td>120</td>
<td>30</td>
</tr>
<tr>
<td>175</td>
<td>35</td>
</tr>
</tbody>
</table>

Average Variable Cost:
Average variable cost (AVC) is total variable cost divided by output. As output increases in the short run, average variable cost tends to fall and then rise. This is for the same reason which accounts for an increase in total variable cost at different rates with increase in output. Table 3 and Fig. 4 show the change in average variable cost with output.

Table 3. Average variable cost:

Fixed and Variable Costs:

In the long run, however, all costs are variable. This is because all factors of production can be altered, if sufficient time is available. For instance, a firm can increase the size of its factory, office or farm. Therefore its rent and business rates would rise and it can hire more workers, pushing up the wage bill.

Fig. 6. depicts total cost in the long run:

In practice, it is not always easy to decide whether a cost is fixed or variable. This is particularly true of payments to workers. It is clear that overtime payments and the wages of temporary workers are variable costs as they vary directly with output.
The basic wage or salary paid to workers, however, may be regarded as a fixed cost since it has to be paid irrespective of the amount of output. Sum of total fixed cost and total variable cost equals total cost. For instance, if fixed costs are $800 and variable costs are $4,200 a week, the total cost of production would be $5,000 a week.

Fig. 5 depicts the constitution of total cost including fixed and “variable costs:

**Average Cost:**
In the short run, average cost consists of average fixed cost and average variable cost. The shape of the short run average cost curve is usually U-shaped. The long run average cost curve is also usually U-shaped. This can be explained as follows. As a firm alters its scale of production, it first experiences economies of scale and then, after reaching a certain output, it may encounter diseconomies of scale.

### Cash Flow Statement: Meaning, Features, Objectives and Importance

**Meaning of Cash Flow Statement:**
A cash flow statement is a statement of changes in the financial position of a firm on cash basis. It reveals the net effects of all business transactions of a firm during a period on cash and explains the reasons of changes in cash position between two balance sheet dates.

It shows the various sources (i.e., inflows) and applications (i.e., outflows) of cash during a particular period and their net impact on the cash balance.

**According to Khan and Jain:**
“Cash Flow statements are statements of changes in financial position prepared on the basis of funds defined as cash or cash equivalents.” The Institute of Cost and Works Accountants of India defines Cash Flow statement as “a statement setting out the flow of cash under distinct heads of sources of funds and their utilisation to determine the requirements of cash during the given period and to prepare for its adequate provision.”

Thus, a cash flow statement is a statement which provides a detailed explanation for the changes in a firm’s cash balance during a particular period by indicating the firm’s sources and uses of cash and, ultimately, net impact on cash balance during that period.

**Features of Cash Flow Statement:**
1. It is a periodical statement as it covers a particular period of time, say, month or year.
2. It shows movement of cash in between two balance sheet dates.
3. It establishes the relationship between net profit and changes in cash position of the firm.
4. It does not involve matching of cost against revenue.
5. It shows the sources and application of funds during a particular period of time.
6. It records the changes in fixed assets as well as current assets.
7. A projected cash flow statement is referred to as cash budget.
8. It is an indicator of cash earning capacity of the firm.
9. It reflects clearly how financial position of a firm changes over a period of time due to its operating activities, investing activities and financing activities.

**Objectives of Cash Flow Statement:**
1. It shows the cash earning capacity of the firm.
2. It indicates different sources from which cash been collected and various purposes for which cash has been utilised during the year.
3. It classifies cash flows during the period from operating, investing and financing activities.
4. It gives answers to various perplexing questions often encountered by management, such as why the firm is unable to pay dividend instead of making enough profit? Why is there huge idle cash balance in spite of loss suffered? Where have the proceeds of sale of fixed assets gone? etc.
5. It helps the management in cash planning and control so that there are no shortage or surplus of cash at any point of time.
6. It evaluates the ability of the firm to meet obligations such as loan repayment, dividends, taxes etc.
7. A prospective investor consults the cash flow statement to ensure that his investment gets regular returns in future.
8. It discloses the reasons for differences among net income, cash receipts and cash payments.
9. It helps the management in taking capital budgeting decisions more scientifically. 10. It ensures optimum use of funds for the maximum benefit of the enterprise.

**Utility or Importance of Cash Flow Statement:**
(a) **Helps to make Cash Forecast:** Cash Flow Statement, no doubt, helps the management to make a cash forecast for the near future. A projected Cash Flow Statement helps the management about the cash position which is the basis for all operations and, thus, the management sees light relating to cash position, viz. how much cash is needed for a specific purpose, sources of internal and external issues, etc.

(b) **Helps the Internal Management:** It helps the internal management to determine the financial policy to be adopted in future since it supplies information relating to funds, e.g. taking decision about the replacement of fixed assets or repayment of long-term liabilities, etc.

(c) **Reveals the Cash Position:** It is a significant pointer about the movement of cash, i.e. whether there is any increase in cash or decrease in cash and the reasons thereof which helps the management. Moreover, it explains the reasons for small cash balance even though there is sufficient profit, or vice versa. Besides, the management can compare the original forecast with the actual one in order to understand the trend of movement of cash and the variation therefore.
(d) Reveals the result of Cash Planning: How far and to what extent the cash planning becomes successful is revealed by the analysis of Cash Flow Statement. The same is possible by making a comparison between the projected Cash Flow Statement/Cash Budget and the actual one—and the measures to be taken accordingly.

Its main advantages are:

1. **Evaluation of Cash Position:** It is very helpful in understanding the cash position of a firm. Since cash is the basis for carrying on business operations smoothly, the cash flow statement is very useful in evaluating the current cash position of the business.

2. **Planning and Control:** A projected cash flow statement enables the management to plan and coordinate the financial operations properly. The financial manager can know how much cash is needed, from where it will be derived, how much can be generated internally, and how much could be obtained from outside.

3. **Performance Evaluation:** A comparison of actual cash flow statement with the projected cash flow statement will disclose the failure or success of the management in managing cash resources. Deviations will indicate the need for corrective actions.

4. ** Framing Long-term Planning:** The projected cash flow statement helps financial manager in exploring the possibility of repayment of long-term debts which depends upon the availability of cash.

5. **Capital Budgeting Decision:** A projected cash flow statement also helps the management in taking capital budgeting decisions.

6. **Liquidity Position:** Liquidity position of a firm refers to its ability to meet short-term obligations such as payment of wages and other operating expenses etc. From cash flow statement the financial manager is able to understand how well the firm is meeting these obligations.

At the same time the ability of the firm in cash earning can be known from cash flow statement. As a matter of fact, a firm’s profitability is ultimately dependent upon its cash earning capacity.

7. **Answers to Different Questions:** Cash flow statement is able to explain some questions often encountered by the financial manager such as, why is the firm not able to pay dividend in spite of making huge profit? Why there is huge cash balance in spite of loss etc.

8. **Ascertaining Liquidity and Profitability Positions:** Cash Flow Statement helps the management to ascertain the liquidity and profitability position of a firm. Liquidity means one’s ability to pay the obligation as soon as it becomes due. Since Cash Flow Statement presents the cash position of a firm at the time of making payment it directly helps to ascertain the liquidity position, the same is also applicable in case of profitability.

One can understand from Cash Flow Statement how efficiently the firm is paying its obligation in various forms of expense and liability. At the same time, as the cash earning capacity of a firm can be ascertained from this statement, profitability position depends also on cash earning capacity.

9. **Ascertaining Optimum Cash Balance:** Cash Flow Statement also helps to ascertain the optimum cash balance of a firm. If optimum cash balance can be determined, it is possible for a firm to ascertain the idle and/or excess and/or shortage of cash position. After ascertaining the cash position, the management can invest the surplus cash, if any, or borrow funds from outside sources accordingly to meet the cash deficit.

10. **Cash Management:** Proper management of cash is possible if Cash Flow Statement is properly prepared. The management can prepare an estimate about the various inflows of cash and outflows of cash so that it becomes very helpful for them to make plans for the future.

11. **Capital Budgeting Decisions:** Since capital budgeting relates to the decision of capital expenditure in various forms on a long-term basis, cash flow timing is very important for this purpose.

12. **Superiority over Accrual Basis of Accounting:** No doubt Cash Flow Statement or cash basis of accounting is more reliable or dependable than accrual basis of accounting—because a number of technical adjustments are made in the latter case. Cash flow accounting is free from such snags.

13. **Planning and Coordination:** Cash Flow Statement is prepared on an estimated basis meant for the successive/next year which helps the management to know how much funds are required for what purposes, how much cash is generated from internal sources, how much cash can be procured from outside the business. It also helps to prepare cash budgets. Thus, the management can prepare plans, coordinate various activities with the help of this statement.

14. **Movement of Cash:** A Cash Flow Statement presents the management the flows in and flows out of cash for various purposes on the basis of which future estimates can be prepared.

15. **Performance Appraisal:** By comparing the actual Cash Flow Statement with the projected Cash Flow Statements, the management can evaluate or appraise the performances regarding cash. If any unfavourable variance is found, the reason for such variation is located and rectified accordingly.

**Limitations of Cash Flow Statement:**

1. Since cash flow statement does not consider non-cash items, it cannot reveal the actual net income of the business.

2. Cash flow statement cannot replace fund flow statement or income statement. Each of them has a separate function to perform which cannot be done by the cash flow statement.

3. The cash balance as disclosed by the projected cash flow statement may not represent the real liquid position of the business since it can be easily influenced by the managerial decisions, by making certain payments in advance or by post ponding payments.

4. It cannot be used for the purpose of comparison over a period of time. A company is not better off in the current year than the previous year because its cash flow has increased.

5. It is not helpful in measuring the economic efficiency in certain cases e.g., public utility service where generally heavy capital expenditure is involved.

In spite of these limitations, it can be said that cash flow statement is a useful supplementary instrument. It helps management in knowing the amount of capital blocked up in a particular segment of the business. The technique of cash flow analysis—when used in conjunction with ratio analysis—serves as a barometer in measuring the profitability and financial position of the business.


**Meaning:** In an ordinary sense, working capital denotes the amount of funds needed for meeting day-to-day operations of a concern.
This is related to short-term assets and short-term sources of financing. Hence it deals with both, assets and liabilities—in the sense of managing working capital. It is the excess of current assets over current liabilities. In this article we will discuss about the various aspects of working capital.

**Concept of Working Capital:** The funds invested in current assets are termed as working capital. It is the fund that is needed to run the day-to-day operations. It circulates in the business like the blood circulates in a living body. Generally, working capital refers to the current assets of a company that are changed from one form to another in the ordinary course of business, i.e. from cash to inventory, inventory to work in progress (WIP), WIP to finished goods, finished goods to receivables and from receivables to cash.

There are two concepts in respect of working capital: (i) Gross working capital and (ii) Net working capital.

- **Gross Working Capital:** The sum total of all current assets of a business concern is termed as gross working capital. So, gross working capital = Stock + Debtors + Receivables + Cash.

- **Net Working Capital:** The difference between current assets and current liabilities of a business concern is termed as the Net working capital. Hence, Net Working Capital = Stock + Debtors + Receivables + Cash – Creditors – Payables.

**Nature of Working Capital:**

- (i) It is used for purchase of raw materials, payment of wages and expenses.
- (ii) It changes form constantly to keep the wheels of business moving.
- (iii) Working capital enhances liquidity, solvency, creditworthiness and reputation of the enterprise.
- (iv) It generates the elements of cost namely: Materials, wages and expenses.
- (v) It enables the enterprise to avail the cash discount facilities offered by its suppliers.
- (vi) It helps improve the morale of business executives and their efficiency reaches at the highest climax.
- (vii) It facilitates expansion programmes of the enterprise and helps in maintaining operational efficiency of fixed assets.

**Need for Working Capital:**

- (i) Adequate working capital is needed to maintain a regular supply of raw materials, which in turn facilitates smoother running of production process.
- (ii) Working capital ensures the regular and timely payment of wages and salaries, thereby improving the morale and efficiency of employees.
- (iii) Working capital is needed for the efficient use of fixed assets.
- (iv) In order to enhance goodwill a healthy level of working capital is needed. It is necessary to build a good reputation and to make payments to creditors in time.
- (v) Working capital helps avoid the possibility of under-capitalization.
- (vi) It is needed to pick up stock of raw materials even during economic depression.
- (vii) Working capital is needed in order to pay fair rate of dividend and interest in time, which increases the confidence of the investors in the firm.

**Importance of Working Capital:**

It is said that working capital is the lifeblood of a business. Every business needs funds in order to run its day-to-day activities.

The importance of working capital can be better understood by the following:

- (i) It helps measure profitability of an enterprise. In its absence, there would be neither production nor profit.
- (ii) Without adequate working capital an entity cannot meet its short-term liabilities in time.
- (iii) A firm having a healthy working capital position can get loans easily from the market due to its high reputation or goodwill.
- (iv) Sufficient working capital helps maintain an uninterrupted flow of production by supplying raw materials and payment of wages.
- (v) Sound working capital helps maintain optimum level of investment in current assets.
- (vi) It enhances liquidity, solvency, creditworthiness and reputation of the enterprise.
- (vii) It provides necessary funds to meet unforeseen contingencies and thus helps the enterprise run successfully during periods of crisis.

**Classification of Working Capital:**

1. **(a) Gross Working Capital:** Gross working capital refers to the amount of funds invested in various components of current assets. It consists of raw materials, work in process, debtors, finished goods, etc.
2. **(b) Net Working Capital:** The excess of current assets over current liabilities is known as Net working capital. The principal objective here is to learn the composition and magnitude of current assets required to meet current liabilities.
3. **(c) Positive Working Capital:** This refers to the surplus of current assets over current liabilities.
4. **(d) Negative Working Capital:** Negative working capital refers to the excess of current liabilities over current assets.
5. **(e) Permanent Working Capital:** The minimum amount of working capital which even required during the dullest season of the year is known as Permanent working capital.
6. **(f) Temporary or Variable Working Capital:** It represents the additional current assets required at different times during the operating year to meet additional inventory, extra cash, etc.

**Components of Working Capital:**

- **(A) Current Assets:**
  - (i) Inventories or Stocks
    - (a) Raw materials
    - (b) Sundry Debtors
    - (c) Bills Receivable
  - (ii) Work in progress
  - (d) Pre-payments
  - (e) Short-term Investments
  - (B) Current Liabilities:
    - (a) Sundry Creditors
    - (b) Bills Payable
    - (c) Bills Receivable
    - (d) Pre-payments
    - (e) Short-term Loans

- **Components of working capital:**
  - (i) Inventories or Stocks
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    - (b) Bills Payable
    - (c) Bills Receivable
    - (d) Pre-payments
    - (e) Short-term Loans

- **Working Capital Management of Working Capital**
Working capital refers to the funds required to meet the day-to-day obligations of business operations. Hence, working capital is said to be the life-blood of an enterprise. The fact remains that it is working capital that keeps the wheel of enterprise on. Working capital, therefore, needs to be maintained at an adequate level.

The reason being both excessive and inadequate working capitals are harmful for an enterprise. For example, if the current assets are inadequate to meet the current liabilities, it will tell upon the liquidity position of the business. In case, the current assets are in excessive volume, the profitability of the business will be adversely affected due to some assets lying idle. Management of working capital means managing different components of current assets and current liabilities.

The same are discussed hereunder:

1. Management of Cash:
   Every enterprise irrespective of its scale requires certain amount of cash to meet its day-to-day obligations. Hence, the enterprise needs to decide carefully how much should be carried in cash. Management of cash aims at striking a fine balance between two contradictory objectives of meeting the cash disbursement needs and minimizing the amount locked up as cash balance.

   For this purpose, cash management addresses to the following four problems:
   1. Controlling the level of cash
   2. Controlling inflows of cash
   3. Controlling outflows of cash
   4. Optimum use of surplus cash

2. Management of Inventory:
   Inventories refer to raw material, work-in-progress and finished goods. These constitute a major portion, about 60% of total current assets. There are three major motives for holding inventories in a firm, namely, transaction motive, precautionary motive and speculative motive.

   But, holding inventories involves costs, i.e. ordering costs and carrying costs.

   Hence, inventories need to be maintained at an optimum size. Inventory management is a trade-off between cost of acquiring and cost of holding inventories. Among various models evolved for managing inventories, the commonly used model is Economic Ordering Quantity (EOQ) Model based on Baumol’s cash management model. The other model of inventory management is ABC Analysis also known as CTE, i.e., Control by Importance and Exception. This method controls expensive inventory items more closely than less expensive items.

3. Management of Accounts Receivable:
   Accounts receivable represent the amount of goods sold on credit with a view to increase the volume of sales. Accounts receivable constitute major portion of current assets. According to the Federation of Indian Chamber of Commerce and Industry (FICCI) study of 417 companies, the ratios of accounts receivable to total assets, current assets and sales were, on average, 17%, 30% and 15% respectively.

   The main objective of maintaining accounts receivable is achieving growth in sales, increasing profits and meeting competition. Like inventories, maintaining accounts receivable also involves certain costs such as capital costs, administrative costs, collection costs and defaulting costs, i.e., bad debts.

   The size of accounts receivable depends on the level of sales, credit policy, terms of trade, efficiency of collection, etc. A larger size of accounts receivable increases profitability and reduces liquidity and vice versa. Therefore, accounts receivable need to be maintained at an optimum size. The optimum size of accounts receivable occurs at a point where there is a “trade-off” between profitability and liquidity. This is depicted in Figure 25.4.

4. Management of Accounts Payable:
   Accounts payable are just reverse to accounts receivable. Accounts payable emerge due to credit purchase. This refers to a loaning of goods and inventories to the buyer. This is also called ‘buy-now, pay-later’. The underlying objective of accounts payable is to slow down the payments process as much as possible.

   But, it should be noted that the saving of interest cost should be offset against loss of credit standing of the enterprise. The enterprise has, therefore, to ensure that the payments to the creditors are made at the stipulated time periods after obtaining the best credit terms possible.

   The salient points to be noted on effective management of accounts payable are:
   a. Obtain most favourable credit terms with the prevailing credit practice.
   b. Make payments on maturity or due dates.
   c. Keep good track record of past dealings with the suppliers.
   d. Avoid tendency to divert payables.
   e. Provide full information to the suppliers.
   f. Keep a constant check on incidence of delinquency.

**Notes on Working Capital Management**

Working capital management implies the management of current assets and current liabilities. Considering the importance of working capital, we can very well, say that the management of working capital is very significant and should be efficient to keep the business going smoothly.

To be more explicit, working capital management includes proper handling of inventories, accounts receivable, cash and bank and liabilities such as accounts payable, outstanding expenses etc. In a big manufacturing organization, working capital occupies a pre-eminent position.

Over half the total assets consists of working capital. So its management deserves careful consideration.

The financial management today, because of various complexities in the market and competitive business environment, finds it necessary to deal with working capital in two parts — overall management and management of each item separately.

Overall management of working capital requires proper estimation of working capital needed for the business, ratios of investments on different items of current assets and proper policy as to the rate of profit earning, possibility of loan procurement, advances etc.

One point is worth noting regarding management of working capital. Since working capital consists of varieties of items, management of one in the desirable way may affect another. For instance, making prompt and regular payments of bills receivable may affect cash balance and the company may face difficulties in liquid cash.

LIquidity, flexibility is to be balanced in working capital management in such a wise and prudent way that the over-all management of the working capital contributes to the general welfare of the company.
Profitability, liquidity, flexibility all is important in managerial exercises but a happy compromise of these factors is no easy task. Financial astuteness is absolutely necessary to ensure a brilliant bright-forward management of working capital.

A deep study of the trend of business is absolutely essential to keep the business on right track. It is all the more important to plan the ratio of different items of working capital in the best interest of the company. It may be that the outside creditors are to be satisfied in the interest of the company but at the same time requisite amount of cash balance must always be kept ready for day-to-day compliance of various obligations. Working capital management formulates policy that is based on experience.

If the policy of the top management is to ensure more profit, then more money is blocked in inventories and cash becomes depleted. It may create problem. Income of the company may suffer if more money is kept always ready to meet any current obligation. Obviously, idle cash does not earn any income.

In regard to cash in hand, working capital management is rather difficult and needs very careful consideration. A company is likely to face an adverse situation if the principles of liquidity and profitability are rigorously followed. Small cash in hand cripples a company to meet the obligation of creditors on demand.

In such a situation small suppliers will be naturally reluctant to supply raw materials to such a company and as a consequence the company will have production difficulty. This will lead to fewer sales and less profit. Therefore, a very balanced ratio profitability and liquidity will have to be maintained through sound management.

It emerges from the above discussion that it is rather impracticable to draw up any invariable standard for the management of working capital. And it also transpires that cash is the major and very sensitive component of working capital, so the working capital management is, as a matter of fact, the management of cash (liquidity) with reference to profitability.

To conclude, working capital management is the planning and controlling of current assets (assets convertible into cash). Working capital indicates circular flow of cash (cash flow cycle). From cash to inventories to receivables and back to cash. The two concepts of working capital are net working capital and gross working capital. Net working capital is a qualitative concept; the management will also get an idea about the ease and cost of raising working capital. Net working capital is measured by the current ratio viz. current assets/current liabilities.

Normally the current ratio should be 2:1. A larger ratio indicates greater solvency and vice versa. Of course, excessive current ratio would point out poor financial planning and it would reduce income. The concept of gross capital is a financial concept whereas that of net concept is an accounting concept. For the management more interest is in the amount of current assets with which it has to operate. “However, in an ever changing economy it is very difficult to secure perfect equilibrium between inflow and outflow of cash”.

So, enough supply of working capital is the objective of sound financial management. While aiming at sound working capital management, certain factors must always be kept in mind. They are:

- (a) Nature of business,
- (b) Size of business,
- (c) Terms of purchase and sale,
- (d) Turnover of inventories,
- (e) Process of manufacture,
- (f) Importance of labour,
- (g) Proportion of raw material to total costs,
- (h) Cash requirements,
- (i) Seasonal variations,
- (j) Banking connections,
- (k) Growth and expansion.

**Capital Structure: Meaning, Concept, Importance and Factors**

**Meaning and Concept of Capital Structure:**

The term ‘structure’ means the arrangement of the various parts. So capital structure means the arrangement of capital from different sources so that the long-term funds needed for the business are raised. Thus, capital structure refers to the proportions or combinations of equity share capital, preference share capital, debentures, long-term loans, retained earnings and other long-term sources of funds in the total amount of capital which a firm should raise to run its business.

**Few definitions of capital structure given by some financial experts:**

“Capital structure of a company refers to the make-up of its capitalisation and it includes all long-term capital resources viz., loans, reserves, shares and bonds.”—Gerstenberg.

“Capital structure is the combination of debt and equity securities that comprise a firm’s financing of its assets.”—John J. Hampton.

“Capital structure refers to the mix of long-term sources of funds, such as, debentures, long-term debts, preference share capital and equity share capital including reserves and surplus.”—I. M. Pandey.

**Capital Structure, Financial Structure and Assets Structure:**

The term capital structure should not be confused with Financial structure and Assets structure. While financial structure consists of short-term debt, long-term debt and share holders’ fund i.e., the entire left hand side of the company’s Balance Sheet. But capital structure consists of long-term debt and shareholders’ fund. So, it may be concluded that the capital structure of a firm is a part of its financial structure. Some experts of financial management include short-term debt in the composition of capital structure. In that case, there is no difference between the two terms—capital structure and financial structure.
So, capital structure is different from financial structure. It is a part of financial structure. Capital structure refers to the proportion of long-term debt and equity in the total capital of a company. On the other hand, financial structure refers to the net worth or owners’ equity and all liabilities (long-term as well as short-term).

Capital structure does not include short-term liabilities but financial structure includes short-term liabilities or current liabilities.

Assets structure implies the composition of total assets used by a firm i.e., make-up of the assets side of Balance Sheet of a company. It indicates the application of fund in the different types of assets fixed and current.

Assets structure = Fixed Assets + Current Assets.

Example:

Note:
The term capitalisation means the total amount of long-term funds at the disposal of the company, whether raised from equity shares, preference shares, retained earnings, debentures, or institutional loans.

**Importance of Capital Structure:**

1. **Increase in value of the firm:** A sound capital structure of a company helps to increase the market price of shares and securities which, in turn, lead to increase in the value of the firm.

2. **Utilisation of available funds:** A good capital structure enables a business enterprise to utilise the available funds fully. A properly designed capital structure ensures the determination of the financial requirements of the firm and raise the funds in such proportions from various sources for their best possible utilisation. A sound capital structure protects the business enterprise from over-capitalisation and under-capitalisation.

3. **Maximisation of return:** A sound capital structure enables management to increase the profits of a company in the form of higher return to the equity shareholders i.e., increase in earnings per share. This can be done by the mechanism of trading on equity i.e., it refers to increase in the proportion of debt capital in the capital structure which is the cheapest source of capital. If the rate of return on capital employed (i.e., shareholders’ fund + long-term borrowings) exceeds the fixed rate of interest paid to debt-holders, the company is said to be trading on equity.

4. **Minimisation of cost of capital:** A sound capital structure of any business enterprise maximises shareholders’ wealth through minimisation of the overall cost of capital. This can also be done by incorporating long-term debt capital in the capital structure as the cost of debt capital is lower than the cost of equity or preference share capital since the interest on debt is tax deductible.

5. **Solvency or liquidity position:** A sound capital structure never allows a business enterprise to go for too much raising of debt capital because, at the time of poor earning, the solvency is disturbed for compulsory payment of interest to the debt-supplier.

6. **Flexibility:** A sound capital structure provides a room for expansion or reduction of debt capital so that, according to changing conditions, adjustment of capital can be made.

7. **Undisturbed controlling:** A good capital structure does not allow the equity shareholders control on business to be diluted.

8. **Minimisation of financial risk:** If debt component increases in the capital structure of a company, the financial risk (i.e., payment of fixed interest charges and repayment of principal amount of debt in time) will also increase. A sound capital structure protects a business enterprise from such financial risk through a judicious mix of debt and equity in the capital structure.

**Factors Determining Capital Structure:**

1. **Risk of cash insolvency:** Risk of cash insolvency arises due to failure to pay fixed interest liabilities. Generally, the higher proportion of debt in capital structure compels the company to pay higher rate of interest on debt irrespective of the fact that the fund is available or not. The non-payment of interest charges and principal amount in time call for liquidation of the company.

   The sudden withdrawal of debt funds from the company can cause cash insolvency. This risk factor has an important bearing in determining the capital structure of a company and it can be avoided if the project is financed by issues equity share capital.

**Balance Sheet of AB Ltd.**

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Rs.</th>
<th>Assets</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity share capital</td>
<td>4,00,000</td>
<td>Land and building</td>
<td>4,40,000</td>
</tr>
<tr>
<td>Preference share capital</td>
<td>1,80,000</td>
<td>Plant and machinery</td>
<td>5,60,000</td>
</tr>
<tr>
<td>Reserve and surplus</td>
<td>1,80,000</td>
<td>Furniture and fixtures</td>
<td>60,000</td>
</tr>
<tr>
<td>15% Debentures</td>
<td>2,60,000</td>
<td>Stock-in-trade</td>
<td>1,24,000</td>
</tr>
<tr>
<td>Term loan from IDBI</td>
<td>2,40,000</td>
<td>Sundry debtors</td>
<td>1,40,000</td>
</tr>
<tr>
<td>Bank overdraft</td>
<td>80,000</td>
<td>Bills receivable</td>
<td>60,000</td>
</tr>
<tr>
<td>Sundry creditors</td>
<td>60,000</td>
<td>Cash and bank balances</td>
<td>76,000</td>
</tr>
<tr>
<td>Outstandings expenses</td>
<td>20,000</td>
<td>Loan and advances</td>
<td>40,000</td>
</tr>
<tr>
<td>Provision for taxation</td>
<td>80,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>15,00,000</td>
<td></td>
<td>15,00,000</td>
</tr>
</tbody>
</table>

You are required to show: (i) the Capital structure, (ii) the Financial structure, and (iii) the Assets structure of AB Ltd.

**Solution:**

(i) **Capital Structure of AB Ltd.**

\[ \text{Capital Structure of AB Ltd.} = \text{Equity Share Capital} + \text{Pref. Share Capital} + \text{Reserve & Surplus} + 15\% \text{Debentures} + \text{Term Loan from IDBI} \]

\[ = Rs. \left( 4,00,000 + 1,80,000 + 1,80,000 + 2,60,000 + 2,40,000 \right) = Rs. 12,60,000 \]

(ii) **Financial Structure of AB Ltd.**

\[ \text{Financial Structure of AB Ltd.} = \text{Equity Share Capital} + \text{Pref. Share Capital} + \text{Reserve & Surplus} + \text{Long Term Debt (Debentures + Term Loan) + Current Liabilities} \]

\[ = Rs. \left( 4,00,000 + 1,80,000 + 1,80,000 + 5,00,000 + 2,40,000 \right) = Rs. 15,00,000 \]

(iii) **Assets Structure of AB Ltd.**

\[ \text{Assets Structure of AB Ltd.} = \text{Fixed Assets} + \text{Current Assets} \]

\[ = Rs. 10,60,000 + Rs. 4,40,000 = Rs. 15,00,000 \]

\[ \text{Capitalisation of AB Ltd.} = \text{Capital Structure or Rs. 12,60,000}. \]
2. Risk in variation of earnings: The higher the debt content in the capital structure of a company, the higher will be the risk of variation in the expected earnings available to equity shareholders. If return on investment on total capital employed (i.e., shareholders’ fund plus long-term debt) exceeds the interest rate, the shareholders get a higher return.

On the other hand, if interest rate exceeds return on investment, the shareholders may not get any return at all.

3. Cost of capital: Cost of capital means cost of raising the capital from different sources of funds. It is the price paid for using the capital. A business enterprise should generate enough revenue to meet its cost of capital and finance its future growth. The finance manager should consider the cost of each source of fund while designing the capital structure of a company.

4. Control: The consideration of retaining control of the business is an important factor in capital structure decisions. If the existing equity shareholders do not like to dilute the control, they may prefer debt capital to equity capital, as former has no voting rights.

5. Trading on equity: The use of fixed interest bearing securities along with owner’s equity as sources of finance is known as trading on equity. It is an arrangement by which the company aims at increasing the return on equity shares by the use of fixed interest bearing securities (i.e., debenture, preference shares etc.). If the existing capital structure of the company consists mainly of the equity shares, the return on equity shares can be increased by using borrowed capital. This is so because the interest paid on debentures is a deductible expenditure for income tax assessment and the after-tax cost of debenture becomes very low.

Any excess earnings over cost of debt will be added up to the equity shareholders. If the rate of return on total capital employed exceeds the rate of interest on debt capital or rate of dividend on preference share capital, the company is said to be trading on equity.

6. Government policies: Capital structure is influenced by Government policies, rules and regulations of SEBI and lending policies of financial institutions which change the financial pattern of the company totally. Monetary and fiscal policies of the Government will also affect the capital structure decisions.

7. Size of the company: Availability of funds is greatly influenced by the size of company. A small company finds it difficult to raise debt capital. The terms of debentures and long-term loans are less favourable to such enterprises. Small companies have to depend more on the equity shares and retained earnings.

On the other hand, large companies issue various types of securities despite the fact that they pay less interest because investors consider large companies less risky.

8. Needs of the investors: While deciding capital structure the financial conditions and psychology of different types of investors will have to be kept in mind. For example, a poor or middle class investor may only be able to invest in equity or preference shares which are usually of small denominations, only a financially sound investor can afford to invest in debentures of higher denominations.

A cautious investor who wants his capital to grow will prefer equity shares.

9. Flexibility: The capital structures of a company should be such that it can raise funds as and when required. Flexibility provides room for expansion, both in terms of lower impact on cost and with no significant rise in risk profile.

10. Period of finance: The period for which finance is needed also influences the capital structure. When funds are needed for long-term (say 10 years), it should be raised by issuing debentures or preference shares. Funds should be raised by the issue of equity shares when it is needed permanently.

11. Nature of business: It has great influence in the capital structure of the business, companies having stable and certain earnings prefer debentures or preference shares and companies having no assured income depends on internal resources.

12. Legal requirements: The finance manager should comply with the legal provisions while designing the capital structure of a company.

13. Purpose of financing: Capital structure of a company is also affected by the purpose of financing. If the funds are required for manufacturing purposes, the company may procure it from the issue of long-term sources. When the funds are required for non-manufacturing purposes i.e., welfare facilities to workers, like school, hospital etc. the company may procure it from internal sources.

14. Corporate taxation: When corporate income is subject to taxes, debt financing is favourable. This is so because the dividend payable on equity share capital and preference share capital are not deductible for tax purposes, whereas interest paid on debt is deductible from income and reduces a firm’s tax liabilities. The tax saving on interest charges reduces the cost of debt funds.

Moreover, a company has to pay tax on the amount distributed as dividend to the equity shareholders. Due to this, total earnings available for both debt holders and stockholders is more when debt capital is used in capital structure. Therefore, if the corporate tax rate is high enough, it is prudent to raise capital by issuing debentures or taking long-term loans from financial institutions.

15. Cash inflows: The selection of capital structure is also affected by the capacity of the business to generate cash inflows. It analyses solvency position and the ability of the company to meet its charges.

16. Provision for future: The provision for future requirement of capital is also to be considered while planning the capital structure of a company.

17. EBIT-EPS analysis: If the level of EBIT is low from HPS point of view, equity is preferable to debt. If the EBIT is high from EPS point of view, debt financing is preferable to equity. If ROI is less than the interest on debt, debt financing decreases ROE. When the ROI is more than the interest on debt, debt financing increases ROE.

Capital Structure: Meaning, Assumptions and Classification

Meaning:
Capital structure refers to the permanent financing of the company, represented by owned capital and loan/debt capital (i.e., Preferred Shares, Equity Shares, Reserves and Long-term Debts).
In other words, it includes all long-term funds invested in the business in the form of Long-term Loans, Preference Shares and Debentures, including Equity Capital and Reserves.

As regards capital structure, the significant point to be noted is the proportion of owned capital and borrowed capital by way of different securities to the total capitalisation for raising finance. Long-term funds can be raised either by the issue of (a) Shares, or (b) Debentures or long-term loans and borrowings.

However, there is an important difference between the two. If funds are raised by the issue of equity shares, it requires dividends only if there is sufficient profits, whereas, in the latter case, it requires a fixed rate of interest irrespective of the profit or loss. Thus, the question of capital gearing arises relating to which fund a fixed rate of interest or dividend is paid.

From a theoretical point of view, capital structure affects either cost of capital or expected yield, or both, of a firm. On the contrary, financing-mix affects the yield per share which belongs to the equity shareholders but do not affect the total earnings, since they are determined by investment decisions of a firm.

In other words, the decisions of capital structure affects the value of the firm by the returns that are made available for the equity shareholders. On the other hand, leverage affects the value of the firm by the cost of capital.

**Assumptions:** The relationship between the Capital Structure and the Cost of Capital can better be understood if we assume:

(i) Two types of capital, viz., debt and equity, are employed;
(ii) Total assets of the firms must be presented;
(iii) Regularity of paying 100% dividends to the shareholders;
(iv) The operating incomes may not be expected to grow further;
(v) Business risk should be constant;
(vi) There will not be any income tax;

**Definition:** In order to explain the theories of capital structure we are to use the following systems in addition to the above assumptions:

- $S =$ total market value of the equity
- $T =$ total market value of the debt
- $V =$ total market value of the firm (i.e., $S + T$)
- $I =$ total interest payable on debt capital
- $NOI/EBIT =$ net operating incomes available to the equity shareholders.

In order to ascertain the total value of the firm, the Equity ($S$) and Debt ($T$) may be summed up as:

$$V = S + T = \frac{1}{K_d} + \frac{EBIT - I}{K_e}$$

Similarly, to calculate Weighted Average Cost of Capital —

$$K_w = W_d K_d + W_e K_e = \left(\frac{T}{V}\right) K_d + \left(\frac{S}{V}\right) K_e$$

where, $W_d =$ Proportion of debt to total value
$W_e =$ Proportion of equity to total value.

Thus, Value of Equity

$$S = \frac{EBIT - I}{K_e}$$

and, Value of Debt

$$T = \frac{1}{K_d}$$

and Debt ($T$) may be summed up as:

The above equations are used by all capital structure theories, the controversy only lies in relation to the degree of leverage of the variable cost of equity ($Ke$), weighted average cost of capital ($Kw$), and total firm's value ($V$).

**Financial Structure and Capital Structure:**

The financial structure of a firm comprises of the various ways and means of raising funds. In other words, financial structure includes all long-term and short-term liabilities. But if short-term (i.e., current) liabilities are excluded the same is known as net worth or capital structure.

It is needless to mention that the difference between the financial structure and the capital structure lies on the treatment of current liabilities/short-term borrowings. Thus, instead of exclusion of current liabilities, if they are included—which is quite justified in a broader sense of the term—there will be no difference between the two.

**Classification of Capital Structure:**

We know that a firm obtains its requirement from various sources and invests the same also in various forms of assets. In other words, a firm has to perform a two-fold aspect for its capital structure application, viz.,

(i) The sources of funds, and
(ii) The applications of such funds.

Thus, the classification of capital structure can be represented as:

(i) According to Sources;
(ii) According to Ownership;
(iii) According to Cost;
(iv) According to Nature and Type.

(i) According to Sources: Sources of funds were broadly highlighted earlier.

(ii) According to Ownership:

**ACCORDING TO OWNERSHIP**

**OWNED CAPITAL**

- Equity Share Capital
- Reserve & Surplus (including retained earnings)

**BORROWED CAPITAL**

- Long-term Loans
- Debentures
- Cash Credit
- Current Liabilities

**SOURCES OF CAPITAL**

**INTERNAL**

- According to ownership, capital is divided into:
  (i) Owned Capital, and
  (ii) Borrowed Capital.

**EXTERNAL**

- Share Capital
- Reserves & Surplus
- Capital Reserves
- Balance of P & L Appropriation Account
- Pref. Share Capital
- Securities Premium
- Debentures
- Long-term and Current Liabilities

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Don't Forget Like And Comment Thanks
(iii) According to Cost:
According to cost, however, capital structure is classified into:
(i) Fixed Cost Capital, and (ii) Variable Cost Capital.

(iv) According to Nature and Type:
There are two types of capital structure according to the nature and type of the firm:
(a) Simple, and
(b) Complex.
(a) Simple:
When the capital structure is composed of Equity Capital only or with Retained Earnings, the same is known as Simple Capital Structure. Example:

(b) Complex:
When capital structure is composed of more than one source or identical nature, the same is known as Complex Capital Structure. In other words, if the capital structure is composed of Equity Share Capital, Preference Share Capital, Retained Earnings, Debentures, Long-term Loans and Current Liabilities etc., the same is known as complex capital structure. Example:

In practice, however, the so-called ‘Simple’ form is not possible. Although a firm may start with the ‘Simple’ type, the same is converted into a ‘Complex’ one in course of time.

Illustration:
From the particulars presented below, calculate the total market value of each of the following firms and ascertain their weighted average cost of capital (Kw) assuming that there is no corporate tax:

---

5 Important Features of an Appropriate Capital Structure of a Company

1. Flexibility: The consideration of flexibility gives the finance manager the ability to alter the firm’s capital structure with a minimum cost and delay, if warranted by the changed environment. It should also be possible for the company to provide funds whenever needed to finance its profitable activities.

2. Profitability: A sound capital structure should permit the maximum use of leverage at a minimum cost so as to provide better profitability and thus maximizing earnings per share.

3. Solvency: Extensive debt threatens the solvency and credit rating of the company. The debt financing should be only to the extent that it can be serviced fully and also be paid back (if required).

4. Conservatism: No company should exceed its debt capacity. As already explained that the interest is to be paid on debt and the principal sum is also to be paid. These payments depend on future cash flows. If future cash flows are not sufficient then the cash insolvency can lead to legal insolvency.

5. Control: The capital structure should not lead to loss of control in the company.

INTRODUCTION TO EXPORT MARKETING – I

1.1 INTRODUCTION
Export marketing means exporting goods to other countries of the world. It involves lengthy procedure and formalities. In export marketing, goods are sent abroad as per the procedures framed by the exporting country as well as by the importing country. Export marketing is more complicated to domestic marketing due to international restrictions, global competition, lengthy procedures and formalities and so on. Moreover, when a business crossed the borders of a nation, it becomes infinitely more complex. Along with this, export marketing offers ample opportunities for earning huge profits and valuable foreign exchange. Export marketing has wider economic significance as it offers various advantages to the national economy. It promotes economic / business / industrial development, to earn foreign exchange and ensures optimum utilization of available resources. Every country takes various policy initiatives for promoting exports and for meaningful participation in global marketing. Global business is a reality and every country has to participate in it for mutual benefits. Every country has to open up its markets to other countries and also try to enter in the markets of other countries in the best possible manner. This is a normal rule which every country has to follow under the present global marketing environment. In the absence of such participation in global marketing, the process of economic development of the country comes in danger.

1.2 DEFINITIONS OF EXPORT MARKETING
1) According to B. S. Rathor “Export marketing includes the management of marketing activities for products which cross the national boundaries of a country”.
2) “Export marketing means marketing of goods and services beyond the national boundaries”.

1.3 FEATURES OF EXPORT MARKETING
The main important features of export marketing are as follows.
1) Systematic Process – Export marketing is a systematic process of developing and distributing goods and services in overseas markets. The export marketing manager needs to undertake various marketing activities, such as marketing research, product design, branding,
packaging, pricing, promotion etc. To undertake the various marketing activities, the export marketing manager should collect the right information from the right source; analyze it properly and then take systematic export marketing decisions.

2) **Large Scale Operations** – Normally, export marketing is undertaken on a large scale. Emphasis is placed on large orders in order to obtain economies in large scale production and distribution of goods. The economies of large scale help the exporter to quote competitive prices in the overseas markets. Exporting goods in small quantities is costly due to heavy transport cost and other formalities.

3) **Dominance of Multinational Corporations** – Export marketing is dominated by MNCs, from USA, Europe and Japan. They are in a position to develop world wide contacts through their network and conduct business operations efficiently and economically. They produce quality goods at low cost and also on massive scale.

4) **Customer Focus** – The focus of export marketing is on the customer. The exporter needs to identify customers’ needs and wants and accordingly design and develop products to generate and enhance customer satisfaction. The focus on customer will not only bring in higher sales in the overseas markets, but it will also improve and enhance goodwill of the firm.

5) **Trade barriers** – Export marketing is not free like internal marketing. There are various trade barriers because of the protective policies of different countries. Tariff and non-tariff barriers are used by countries for restricting import. The export marketing manager must have a good knowledge of trade barriers imposed by importing countries.

6) **Trading Blocs** – Export trade is also affected by trading blocs, certain nations form trading bloc for their mutual benefit and economic development. The non-members face problems in trading with the members of a trading bloc due to common external barriers. Indian exporters should have a good knowledge of important trading blocs such as NAFTA, European Union and ASEAN.

7) **Three** – faced competition – In export markets, exporters have to face three-faced competition, i.e., competition from the three angles – from the other suppliers of the exporter’s country, from the local producers of importing country and from the exporters of competing nations.

8) **Documentation** – Export marketing is subject to various documentation formalities. Exporters require various documents to submit them to various authorities such as customs, port trust etc. The documents include – Shipping Bill, Consular Invoice, Certificate of Origin etc.

9) **Foreign exchange regulations** – Export trade is subject to foreign exchange regulations imposed by different countries. These regulations relate to payments and collection of export proceeds. Such restrictions affect free movement of goods among the countries of the world.

10) **Marketing** – mix Export marketing requires the right marketing mix for the target markets, i.e. exporting the right product, at the right price, at the right time and with the right promotion. The exporter can adopt different marketing – mixes for different export markets, so as to maximize exports and earn higher returns.

11) **International Marketing Research** – Export marketing requires the support of marketing research in the form of market survey, product survey, product research and development as it is highly competitive. Various challenges, identification of needs and wants of foreign buyer in export marketing can be dealt with through international marketing research.

12) **Spreading of Risks** – Export marketing helps to spread risks of business. Normally export firms sell in a number of overseas markets. If they are affected by risks (losses) in one market, they may be able to spread business risks due to good return from some other markets.

13) **Reputation** – Export marketing brings name and goodwill to the export firm. Also, the country of its origin the gets reputation. The reputation enables the export firm to command good sales in the domestic market as well as export market.

### 1.4 IMPORTANCE OF EXPORT MARKETING

Exports are important for all countries whether developed or underdeveloped. The need / importance / advantages of export marketing can be explained from the viewpoint of a country and that of business organization.

#### 1.4.1 Need / Importance / Advantages of Export Marketing at the National Level:

1) **Earning foreign exchange** – Exports bring valuable foreign exchange to the exporting country, which is mainly required to pay for import of capital goods, raw materials, spares and components as well as importing advance technical knowledge.

2) **International Relations** – Almost all countries of the world want to prosper in a peaceful environment. One way to maintain political and cultural ties with other nations is through international trade.

3) **Balance of payment** – Large scale exports solve balance of payments problem and enable countries to have favourable balance of payment position. The deficit in the balance of trade and balance of payments can be removed through large-scale exports.

4) **Reputation in the world** – A country which is foremost in the field of exports, commands a lot of respect, goodwill and reputation from other countries. For example, Japan commands international reputation due to its high quality products in the export markets.

5) **Employment Opportunities** – Export trade calls for more production. More production opens the doors for more employment. Opportunities, not only in export sector but also in allied sector like banking, insurance etc.

6) **Promoting economic development** – Exports are needed for promoting economic and industrial development. The business grows rapidly if it has access to international markets. Large-scale exports bring rapid economic development of a nation.

7) **Optimum Utilization of Resources** – There can be optimum use of resources. For example, the supply of oil and petroleum products in Gulf countries is in excess of home demand. So the excess production is exported, thereby making optimum use of available resources.

8) **Spread Effect** – Because of the export industry, other sectors also expand such as banking, transport, insurance etc. and at the same time number of ancillary industries comes into existence to support the export sector.

9) **Higher standard of Living** – Export trade calls for more productions, which in turn increase employment opportunities. More employment means more purchasing power, as a result of which people can enjoy new and better goods, which in turn improves standard of living of the people.

#### 1.4.2 Need / Importance / Advantages of export marketing at Business / Firm / Enterprise Level

1) **Reputation** – An organization which undertakes exports can bring fame to its name not only in the export markets, but also in the home market. For example, firms like Phillips, HLL, Glaxo, Sony, coca cola, Pepsi, enjoy international reputation.

2) **Optimum Production** – A company can export its excess production after meeting domestic demand. Thus, the production can be carried on up to the optimum production capacity. This will result in economies of large scale production.
3) Spreading of Risk – A firm engaged in domestic as well as export marketing can spread its marketing risk in two parts. The loss is one part (i.e. in one area of marketing) can be compensated by the profit earned in the other part / area.

4) Export obligation – Some export organization are given certain concessions and facilities only when they accept certain export obligations. Large-scale exports are needed to honour such export obligations in India, units operating in the SEZs / FTZs are expected to honour such export obligations against special concessions offered to them.

5) Improvement in organizational efficiency – Research, training and the experience in dealing with foreign markets, enable the exporters to improve the overall organizational efficiency.

6) Improvement in product standards – An export firm has to maintain and improve standards in quality in order to meet international standards. As a result, the consumers in the home market as well as in the international market can enjoy better quality of goods.

7) Liberal Imports – Organizations exporting on a large-scale collect more foreign exchange which can be utilized for liberal import of new technology, machinery and components. This raises the competitive capacity of export organizations.

8) Financial and non-Financial benefits – In India, exporters can avail of a number of facilities from the government. For example, exporters can get DBK, tax exemption etc. They also can get assistance from export promotion organizations such as EPCs HIP, etc.

9) Higher profits – Exports enable a business enterprise to earn higher prices for goods. If the exporters offer quality products, they can charge higher prices than those charged in the home market and thereby raise the profit margin. Check your progress

1. Define Export Marketing.
2. “Export is important for all the countries whether developed or underdeveloped.” Explain.

1.5 DIFFERENCE BETWEEN DOMESTIC MARKETING AND EXPORT MARKETING.

<table>
<thead>
<tr>
<th>Domestic / Home marketing</th>
<th>Export / International marketing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Meaning – Domestic marketing is restricted to political boundaries of a country. It involves buying and selling activities within one country only</td>
<td>International marketing covers all countries for marketing purpose. It involves buying and selling activities at the global level.</td>
</tr>
<tr>
<td>2) Nature – Domestic marketing is easy and simple due to several reasons such as uniform currency system, limited trade restrictions, uniform trade practices and short distances for transport of goods.</td>
<td>International marketing is difficult and complicated due to reasons such as use of different currencies, trade restrictions long distances and absence of uniform trade practices.</td>
</tr>
<tr>
<td>3) Trading Blocs – Absence of trading blocs and tariff and non-tariff barriers provide ample scope for expansion in domestic marketing activities.</td>
<td>Trading blocs and tariffs and non-tariff barriers exist in international marketing and they restrict free trade among the countries of the world.</td>
</tr>
<tr>
<td>4) Licensing and procedures – It is free from licensing and lengthy procedures and formalities. This brings simplicity in trading operation</td>
<td>It involves licensing, permissions and lengthy procedures. This makes marketing operations complicated, time-consuming and difficult.</td>
</tr>
<tr>
<td>5) Environmental changes – Changes in the economic, political or social environment create limited effects on domestic marketing</td>
<td>Changes in the economic, political or social environment create far-reaching effects on international marketing scenario</td>
</tr>
<tr>
<td>6) Risk in trade – The risk involved is limited due to limited area of operations, political stability and uniform rules and laws.</td>
<td>The risk involved is heavy due to vast area of operations, highly sensitive nature of markets and political factors.</td>
</tr>
<tr>
<td>7) Competition – It is not highly competitive. The scope for competition is restricted due to uniform business environment.</td>
<td>It is highly competitive as different countries involved are in different stages of economic and industrial growth.</td>
</tr>
<tr>
<td>8) Government Interference – Least interference in the domestic marketing activities.</td>
<td>Maximum interference is observed in international marketing activities.</td>
</tr>
<tr>
<td>9) Division – It has no division as it is one integrated marketing activity.</td>
<td>It has two broad divisions. Foreign marketing and multinational marketing.</td>
</tr>
<tr>
<td>10) Quantities involved – Domestic marketing activities are conducted in small quantities with limited profit potentials.</td>
<td>International marketing activities are always in large quantities and profit potentials are also more.</td>
</tr>
<tr>
<td>11) Incentives – In home marketing, special concessions, facilities and incentives are normally not offered to traders and manufacturers.</td>
<td>In export marketing, special incentives, facilities and concessions are offered to manufacturers of export oriented goods and exporters.</td>
</tr>
<tr>
<td>12) Agencies Involved – Agencies involved in home marketing include wholesalers, retailers and other trading organizations.</td>
<td>Agencies in export marketing include manufacturer – exporters, merchant exporters, export houses and trading houses.</td>
</tr>
<tr>
<td>13) Method of payment – In domestic marketing payment is through cash or cheque.</td>
<td>Payment in international marketing is through letter of credit and documentary bills of exchange.</td>
</tr>
<tr>
<td>14) Use of currency – It involves the use of one currency. For example Rupee in India.</td>
<td>It involves the use of multiple currencies particularly US $.</td>
</tr>
</tbody>
</table>

1.6 MOTIVATIONS FOR EXPORT MARKETING

Companies have to take several decisions to participate in export marketing. There are some basic economic reasons which influence a company decision regarding participation in export business. Such reasons can be treated as motivators for export marketing. These motivational factors for export marketing are as follows.

a) Rate of profit – The rate of profit in export business is normally higher as compare to rate of profit in domestic marketing. The unit value realization of export products normally increases. Such progressive improvement in the unit value of realization is one reason which acts as a motivator for exporting.

b) Sales and production stability – Export marketing may enable a firm to maintain sales and production stability. For example, in the case of seasonal products, exporting may help to achieve sales stability, because the seasons may be opposite in certain export markets. For example, woolen clothing.
c) Inadequate domestic demand – The level of domestic demand may be insufficient for utilizing the available production capacity fall, i.e., at the optimum level. Here, the company enters in export marketing so that the available production capacity will be utilized fully for meeting domestic demand and demand from abroad. This is one motivational factor for export marketing.

d) Economic growth – Growth is another major reason for internationalization. The growth potential of many foreign markets is a very strong attraction for foreign companies. Several developing countries like China, India, have been growing at a much faster rate than the developed countries. Many multinational companies are eager to establish their foothold in such countries, considering future potential.

e) Reducing business risks – Geographical diversification facilitates distribution of business risks among different export markets. Even the risks in internal marketing can be reduced by undertaking export marketing. A diversified business spreads business risks among different markets.

f) Information and media Revolution – There has been tremendous growth in the field of information and media. For example, internet facility has given a big boost to a global trade. Now, business firms can conduct global operations with much investment in setting up elaborate offices. Business activities in other countries can be conducted through information network.

g) Strategic vision – Some firms have a strategic vision to enter in export markets. The business strategy of such firms includes systematic international growth. Therefore, the stimulus for export marketing comes from desire to grow and expand, need to become more competitive.

h) Accepting social responsibility – Export promotion is a collective responsibility of all social groups including business enterprises. Some large enterprises accept this social obligation and participate in export marketing. Here, social responsibility acts as a motivation for export marketing.

i) Government policies – Government policies and Regulations may also encourage the companies for international marketing. Some companies export and invest in foreign countries to avail economic incentives, and benefits provided by the government. Also some companies internationalize due to government’s emphasis on import development and foreign investment. In India, certain companies export in order to fulfill their export obligation.

j) W. T. O. - Due to WTO, member nations have reduced a number of restrictions on foreign investment, and trade in goods and services. For example, the custom duties have been reduced world wide. This has motivated business firms to enter in the global markets to a greater extent.

k) Benefit of bulk selling – Export business is normally in bulk quantity. Export orders are much larger as compared to orders in domestic marketing. Export business is undertaken in order to take the benefits of selling in bulk i.e. in large quantities. It helps to earn foreign exchange in large. In brief, export marketing offers many benefits to exporting organization. Such benefits encourage companies to participate in export marketing. The benefits also act as motivators for export marketing.

1.7 PRESENT PROBLEMS / DIFFICULTIES FACED BY INDIAN EXPORTERS

At present, Indian exporters face a number of problems / difficulties. The problem demotivates the business firms to enter into foreign markets. These problem / difficulties are as follows.

a) Recession in world market - The world market, faced recession in 2008 and in the first half of 2009. The recession was triggered due to sub-prime crisis of USA in September 2007. Due to recession, the demand for several Indian items such as Gems and Jewellery, Textiles and Clothing and other items were badly hit. During recession, exporters get low orders from overseas markets, and they have to quote lower prices. Therefore, exporter gets law profits or suffers from losses.

b) Technological differences - The developed countries are equipped with sophisticated technologies capable of transforming raw materials into finished goods on a large scale. Less developed countries, on the other hand, lack technical knowledge and latest equipments. And therefore they have to use their old and outdated technologies. It leads to the lopsided development in the international market.

c) Reduction in export Incentives – Over the years, the Govt. of India has reduced export incentives such as reduction in DBK rates, withdrawal of income tax benefits for majority of exporters, etc. The reduction in export incentives demotivates exporters to export in the overseas markets.

d) Several competitions in global marketing – Export marketing is highly competitive. This competition relates to price, quality, production cost and sales promotion techniques used. Indian exporters face three-faced competition while exporting. This includes competition from domestic exporters, local producers where the goods are being exported and finally from producers of competing countries at global level. Such competition is one special problem to the exporters.

e) Problem of product standards – Developed countries insist on high product standards from developing countries like India. The products from developing countries like India are subject to product tests in the importing countries. At times, the importing countries do not allow imports of certain items like fruits, textiles and other items on the grounds of excess toxic content. Therefore Indian exporters lose markets especially in developed countries.

f) Fluctuations in Exchange Rate – Every country has its own currency which is different from international currencies. The dominant international currencies are US dollar or Sterling Pound. From the point of view of Indian exporters we are interested to realize the payment in international currency. Foreign exchange earned by the operators is converted into Indian rupees and paid to the exporters in Indian currency; this exposes the exporters to the dangers of fluctuation in foreign exchange rates.

g) Problems of Sea Pirates Attacks – A major risk faced by international trade is attack by pirates in the Gulf of Aden. More than half of India’s merchandise trade passes through the piracy infested Gulf of Aden. New exporters and importers are facing problem, because of increased pirate attacks as they find it difficult to get insurance cover.

h) Problem of subsidies by Developed countries – The developed countries like USA provide huge subsidies to their exporters. For example, in case of agriculture exporters, USA, UK and other provide huge subsidies to their exporters. Therefore, the exporters of developing countries like India find it difficult to face competition in the world markets.

i) Problem in preparing Documents – Export involves a large number of documents. The exporter will have to arrange export documents required in his country and also all the documents as mentioned in the documentary letter of credit. In India, there are as many as 25 documents (16 commercial and a regulatory documents) to be filled in.
10 Major Problems faced by the Small Scale Industries of India

Major problems faced by the small scale industries are: (1) Finance (2) Raw Material (3) Idle Capacity (4) Technology (5) Marketing (6) Infrastructure (7) Under Utilisation of Capacity (8) Project Planning!

Small scale industries play a vital role in the economic development of our country. This sector can stimulate economic activity and is entrusted with the responsibility of realising various objectives generation of more employment opportunities with less investment, reducing regional imbalances etc. Small scale industries are not in a position to play their role effectively due to various constraints. The major causes of this problem.

Firstly, adequate funds are not available and secondly, entrepreneurs due to weak economic base, have lower credit worthiness. Neither they are having their own resources nor are others prepared to lend them. Entrepreneurs are forced to borrow money from money lenders at exorbitant rate of interest and this upsets all their calculations.

After nationalisation, banks have started financing this sector. These enterprises are still struggling with the problem of inadequate availability of high cost funds. These enterprises are promoting various social objectives and in order to facilitate their working adequate credit on easier terms and conditions must be provided to them.

(2) Raw Material: Small scale industries normally tap local sources for meeting raw material requirements. These units have to face numerous problems like availability of inadequate quantity, poor quality and even supply of raw material is not on regular basis. All these factors adversely affect the functioning of these units.

Large scale units, because of more resources, normally corner whatever raw material that is available in the open market. Small scale units are thus forced to purchase the same raw material from the open market at very high prices. It will lead to increase in the cost of production thereby making their functioning unviable.

(3) Idle Capacity: There is under utilisation of installed capacity to the extent of 40 to 50 percent in case of small scale industries. Various causes of this under-utilisation are shortage of raw material problem associated with funds and even availability of power. Small scale units are not fully equipped to overcome all these problems as is the case with the rivals in the large scale sector.

(4) Technology: Small scale entrepreneurs are not fully exposed to the latest technology. Moreover, they lack requisite resources to update or modernise their plant and machinery. Due to obsolete methods of production, they are confronted with the problems of inferior quality and that too at higher cost. They are in no position to compete with their better equipped rivals operating modern large scale units.

(5) Marketing: These small scale units are also exposed to marketing problems. They are not in a position to get first hand information about the market i.e. about the competition, taste, liking, disliking of the consumers and prevalent fashion.

With the result they are not in a position to upgrade their products keeping in mind market requirements. They are producing less of inferior quality and that too at higher costs. Therefore, in competition with better equipped large scale units they are placed in a relatively disadvantageous position.

In order to safeguard the interests of small scale enterprises the Government of India has reserved certain items for exclusive production in the small scale sector. Various government agencies like Trade Fair Authority of India, State Trading Corporation and the National Small Industries Corporation are extending helping hand to small scale sector in selling its products both in the domestic and export markets.

(6) Infrastructure: Infrastructure aspects adversely affect the functioning of small scale units. There is inadequate availability of transportation, communication, power and other facilities in the backward areas. Entrepreneurs are faced with the problem of getting power connections and even when they are lucky enough to get these they are exposed to unscheduled long power cuts.

Inadequate and inappropriate transportation and communication network will make the working of various units all the more difficult. All these factors are going to adversely affect the quantity, quality and production schedule of the enterprises operating in these areas. Thus their operations will become uneconomical and unviable.
(7) Under Utilisation of Capacity: Most of the small-scale units are working below full potentials or there is gross underutilization of capacities. Large scale units are working for 24 hours a day i.e. in three shifts of 8 hours each and are thus making best possible use of their machinery and equipments. On the other hand small scale units are making only 40 to 50 percent use of their installed capacities. Various reasons attributed to this gross under-utilisation of capacities are problems of finance, raw material, power and underdeveloped markets for their products.

(8) Project Planning: Another important problem faced by small scale entrepreneurs is poor project planning. These entrepreneurs do not attach much significance to viability studies i.e. both technical and economical and plunge into entrepreneurial activity out of mere enthusiasm and excitement. They do not bother to study the demand aspect, marketing problems, and sources of raw materials and even availability of proper infrastructure before starting their enterprises. Project feasibility analysis covering all these aspects in addition to technical and financial viability of the projects, is not at all given due weight-age. Inexperienced and incomplete documents which invariably results in delays in completing promotional formalities. Small entrepreneurs often submit unrealistic feasibility reports and incompetent entrepreneurs do not fully understand project details. Moreover, due to limited financial resources they cannot afford to avail services of project consultants. This result is poor project planning and execution. There is both time interests of these small scale enterprises.

(9) Skilled Manpower: A small scale unit located in a remote backward area may not have problem with respect to unskilled workers, but skilled workers are not available there. The reason is Firstly, skilled workers may be reluctant to work in these areas and secondly, the enterprise may not afford to pay the wages and other facilities demanded by these workers. Besides non-availability entrepreneurs are confronted with various other problems like absenteeism, high labour turnover indiscipline, strike etc. These labour related problems result in lower productivity, deterioration of quality, increase in wastages, and rise in other overhead costs and finally adverse impact on the profitability of these small scale units.

(10) Managerial: Managerial inadequacies pose another serious problem for small scale units. Modern business demands vision, knowledge, skill, aptitude and whole hearted devotion. Competence of the entrepreneur is vital for the success of any venture. An entrepreneur is a pivot around whom the entire enterprise revolves. Many small scale units have turned sick due to lack of managerial competence on the part of entrepreneurs. An entrepreneur who is required to undergo training and counseling for developing his managerial skills will add to the problems of entrepreneurs. The small scale entrepreneurs have to encounter numerous problems relating to overdependence on institutional agencies for funds and consultancy services, lack of credit-worthiness, education, training, lower profitability and host of marketing and other problems. The Government of India has initiated various schemes aimed at improving the overall functioning of these units.