
UNIT 1 BEING AN ENTREPRENEUR: WHAT DOES IT INVOLVE?

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1.0 OBJECTIVES

After reading this unit, you should be able to:

- differentiate between Wage-employment & Self-employment;
- assess the benefit of self-employment;
- evaluate the risk taking behaviour in goal setting;
- become aware of business opportunities; and
- appreciate the linkage between economy & entrepreneurship.

1.1 INTRODUCTION

“Being an entrepreneur” a Career option. “Self-help is the best help” applies in case one chooses to become an entrepreneur. It is not only running and managing an enterprise but also creating jobs for others. It also means taking challenges by utilizing all available resources. Let us now understand how an entrepreneur goes through this process

1.2 BECOMING AN ENTREPRENEUR

As you grow up you have to think about what you would like to do in order to earn your living. If you look around you will find that different people are doing different activities to earn money to look after their family and to lead a decent life. They are choosing different careers based on their knowledge, and experience. For young persons like you, there are two career alternatives:

- a) **wage-employment**, i.e. taking a job and serving the boss for a monthly salary
- b) **self-employment**, i.e. to start any economic activity of your own for being self-employed. In self-employment, once the activity grows it can also generate wage-employment for others, then it is called **entrepreneurship**. The person who practises entrepreneurship is called an **entrepreneur**.

An entrepreneur is defined as “person in effective control of commercial undertaking; one who undertakes a business or an enterprise”.

The economic activity in self-employment may be a small business, a manufacturing unit or a service-cum-repair unit. Individuals generally choose self-employment for the following reasons:

- i) Self-employment provides a solution to the problem of unemployment. Unemployment exists to a large extent in rural and urban areas and among the educated and uneducated in India. Hence, the need to promote self-employment.
- ii) One self-employed individual can also offer employment to others. The best scope for self-employment exists in a variety of small business like, retail trade, small stores, repair-cum-servicing units, newspaper stalls, dealership-based business activities, small catering places, franchise-based soft-drink vending, ice-cream and small servicing stations, small manufacturing units, etc.

1.3 NEED FOR ENTREPRENEURSHIP

Let us understand the need for and significance of entrepreneurship.

- **Increases national production**

More and more entrepreneurs are developed they contribute directly to product and process development which in turn increases national economy. For example, more entrepreneurs in the area of food processing sector would be able to maximize the uses of raw material, and the products in food industries would increase.

- **Balanced area development**

As more entrepreneurs are developed both in rural and urban sectors, it will decrease the dispersal of the people from rural areas to urban areas. It will also help the rural industries to grow as well as the industrially backward areas in the country.

- **Dispersal of economic power**

It is a process of empowering people. People can have “power” either through muscle, status or money. Entrepreneurship helps to balance “power” through participation, economic gain and position in the society.

- **Reinvestment of profit for the welfare of the area of profit generation**

It has been observed that entrepreneurial community or people in a particular area would reinvest their profit for the development of roads, infrastructure as well as for the welfare of the people. Take for example,

what contributions have been made by the well-known entrepreneurs like Tata's, Birla's and Reliance.

- **Development is a function of motivation and human resource**

Any development requires participation of human resources. These people have to be motivated for contributing towards development. Entrepreneurship truly contributes to development through the participation of people who are motivated, energetic and have a concern for growth.

- **Entrepreneurial awareness**

There is a need for creating mass awareness among the people whether they are students, unemployed youth, artisans, retired personnel, or housewives to be aware about entrepreneurship. More and more entrepreneurs lead to economic development.

1.4 BENEFITS TO THE SELF-EMPLOYED

- a) Self-employment offers perhaps the best opportunity for gainful use of one's own capabilities and time.

It is gainful because it generates income for the self-employed individual. In short, one can earn livelihood based on self-employment.

- b) Self-employment develops initiative and ability to plan and manage business activity on the part of the individual.

Thus, it offers scope for development of the individual.

- c) In a self-employment situation one learns many things 'on the job' because one has to take all the decisions and also manage the business.

One learns and develops through self-employment.

- d) In self-employment one can grow and expand one's own business and be innovative.

One learns to be innovative and growth-oriented. Thus, self-employment develops initiative and ability to plan, decide and manage one's own business. The saying "self-help is the best help" applies here also very well.

1.5 WHO IS AN ENTREPRENEUR?

Once you are self-employed you may like to grow and expand so as to become big to achieve great heights in life, one needs to take initiative and be on one's own. If you look around you will find that all those who have become rich and have earned a big name have become so by starting their own enterprises rather than by seeking jobs. In this way, the educated person does not become a burden on the nation but rather builds the nation by starting a small enterprises, which may be a small industrial enterprise to start with, but over a period of time it becomes a large industry. These are the people who are called entrepreneurs.

- i) Becoming an Entrepreneur would mean to own one's tasks\jobs, organize activities, and manage and run an enterprise assuming the risk of a business.

- ii) Being an entrepreneur would mean independence and having control over one's own life?
- iii) Being an entrepreneur would mean being innovative and reaching towards excellence.
- iv) Being an entrepreneur would mean creating job opportunities for others.
- v) Being an entrepreneur would also mean sensing economic opportunities.

Entrepreneurs have specific qualities; they have special strengths which they draw upon for their foray into business. If you want to start your own enterprise and make it a success, you will have to play different roles at different times and at different stages of the growth of your enterprise. Let us understand some of the special qualities that an entrepreneur needs to develop.

1.6 SETTING CHALLENGING GOAL – RISK TAKING

Risk-taking is an important aspect of entrepreneurial life. Entrepreneurs are calculated risk-takers. They do not aim at goals that can be very easily accomplished. They like challenges. They also do not aim at tasks that are very difficult to accomplish, as they would enjoy a sense of success attained only after accomplishing a challenging goal. They are moderate risk-takers. Moderate or calculated risk-taking involves a number of processes, stated below:

- a) Understanding the situation
- b) Gathering as much information as possible
- c) Assessing one's own resources
- d) Setting challenging goals for oneself, on the basis of the information and resources
- e) Testing one's own abilities
- f) Modifying the goals set on the basis of previous experience (one's own and others).

To be personally responsible for the risks involved in the establishment of an enterprise may be considered as one of the important dimensions of entrepreneurial behaviour. Entrepreneurs have, however, certain characteristic attitudes towards risk. Generally, the choice of an occupation is because of the 'fear of failure'. However, in the choice of an entrepreneur, the fear of failure forms the least important consideration. The entrepreneur bears the risk of launching a new business. Nonetheless, while opting for a risk, he does not like to play the gambler.

1.6.1 The Entrepreneur and the Gambler

The difference between a gambler and an entrepreneur needs to be clearly understood for a proper appreciation of entrepreneurial behaviour.

When a gambler takes risks, the person is primarily concerned with the pay off which is solely determined by the result of a "chance". The gambler operates without using the earlier experience. In gambling, such event is independent of any pay off.

On the other hand, even though the entrepreneur also stakes and hopes, he continuously intervenes to influence the outcome. In such a situation, the person is aware that any intervention, even in the most certain situations, makes all the difference to the outcome. Such awareness is confirmed by experience. It would be appropriate to say that an entrepreneur takes only such risks where one cannot control the outcome. The feelings or awareness, which is confirmed that the outcome can be controlled by interventions, marks the demarcating line between gambling and the calculated risk-taking.

In gambling, learning is not possible, whereas entrepreneurial risk-taking is mainly governed by learning. In the former, it is not possible to calculate long-term objective probabilities or odds. Such objective probabilities may be almost denied or not available to the entrepreneurial activity. Only the denial of the objective calculation of risk, however, does not make all the difference between gambling and an entrepreneurial venture. The sense of control, the possibility of learning, and the presence of moderate risk and subjectivity lead to entrepreneurial activity.

1.6.2 Moderate Risk Taking

The concept of taking a challenge or stretching explains better the concept of moderate risk-taking. One takes a challenge if the goal is personally meaningful, the outcome is dependent on one's effort, and the goal is a little beyond one's capabilities, holding in store a lurking possibility of even a failure. The same is true of the concept of 'stretching'. One is likely to stretch oneself if the goal appears a little beyond one's reach, if it is personally meaningful, i.e. if it has any personal marginal utility, and its attainment largely depends on one's effort. Stretching results from the hope of success. On the other hand, a person with a low hope of success or a high fear of failure is likely to choose goals, which are well within one's capacity, thereby ensuring a low probability of failure. In the latter case, the concern is not about success or achievement, but about non-failure. Very often, by congenital standards, these people appear to be succeeding. In effect, they have chosen to operate well within their natural capacity. A person operating from the hope of success, however, is likely to increase the capacities because of inclination towards stretching.

1.7 SENSING OPPORTUNITIES

Let us understand yet another important problem faced in entrepreneurial life, "Sensing Opportunity" what is opportunity? It may be a chance to do something new; it may also be a way of getting something for nothing? or it may be a job or admission to a school or college. While these are, no doubt, opportunities, there is another type of opportunity that exists in our environment, which we most often fail to notice. We call it by the general term: problem Problems, pose a challenge to entrepreneurs, and in solving them, they find opportunities. For an entrepreneur it is like saying "If you have a problem, then it is my opportunity".

Opportunities for launching new enterprises exist in the environment everywhere but all of us are not able to perceive them. Even if we do, we only see an opportunity in retrospect. The good idea was there but it is usually a case of "Why didn't I think of it first?" Entrepreneurs however, perceive opportunities quickly, synthesize the available information and analyze

emerging patterns that escape others. They are people with a vision, capable of persuading others such as customers, partners, employees and suppliers to see the opportunity, share it and support it. For them the opportunity exists, as we have seen before, in the environment in the form of needs and problems of people and society. After spotting the opportunity, they evolve a strategy to find a creative solution to the problem or need.

Apart from perceiving an opportunity that already exists in the environment, it is also possible to create or craft business opportunities. Many great inventions like the microwave and the mobile phones are the examples of created opportunities. They are born out of fantasies of entrepreneurs about products or services they would love to have in their lives. It requires lot of ideas which can be generated. We will now try to understand how these ideas can be generated and what are its sources?

1.7.1 Sources of Idea

By following different ways for generating ideas an entrepreneur collects a number of ideas. The process of generation of ideas can be streamlined by developing awareness for different 'Idea fields'. This helps the entrepreneur in enlarging the scope of thinking, at the same time structuring the ideas according to convenient frames of reference. Thus idea fields can be described as convenient frames of reference for streamlining the process of generation of ideas.

a) Natural resources

Ideas can be generated based on natural resources. A product or service may be desired from forest resources, agriculture, horticulture, mineral, marine or aqua mineral, animal husbandry, wind, sun and human resources. A further exercise with a field may generate many useful product ideas. For instance, if we are getting ideas in the field of forest resources, we can think of forest produce, wood-based product, bio-fertilizer etc. Similarly if it is horticulture, we can generate a number of ideas for food preservation, canning, freezing, juices, squashes, pulp, jam pickles etc. Similar exercises can be done with almost all the other natural resources.

b) Existing products or services

There is also a continuous and consistent effort on the part of all entrepreneurs to improve the products and services already in the market. When black and white computer screen came into use, immediately entrepreneurs started thinking of introducing colour monitors. There are new techniques and strategies being developed in every service like teaching, medicine, management etc.

So thinking about existing products and services can generate a number of ideas to improve them or to provide a cheaper substitute or to bring about a reduction in price. It can also help in deciding whether similar projects can be established, whether new products can work as raw material for existing units, whether new products can be developed from the waste or by products of existing units and whether there is scope for packaging and other services for existing products. For example, when an automobile unit is established in an area, attempts can be made to ascertain whether a few parts or components for the automobile can be produced in the small scale sector. Similarly where a perfume unit is functioning, there is scope for

growing and supplying aromatic plants. Or essential oils can be purchased from existing units and final products such as medicine or cosmetic products can be manufactured. These types of backward and forward linkages of existing business activities are a good source of new ideas.

c) Market-driven or demand-driven ideas

We have already seen that one important method for generating ideas is to carry out a market research. Such a study yields valuable data about trends of supply, demand, consumer preferences etc. Sometimes information related to different products is available with associations and organizations, which carry out routine market surveys. Whatever the source of information about the market, it is a promising field for generation of ideas.

For instance, if through a market survey we learn that there is a gap between supply and demand for stationery in the beginning of school or college year, it can be a good opportunity to start a venture using this information. Similarly if the market survey reveals that a particular product is being imported, efforts can be made to find an import substitute. Indian space technology has witnessed a tremendous boost because of the development of indigenous technology.

In the service sector, it is booming time. There are many ideas that have transformed into reality. For instance, too much of pesticides, which is harmful for health, has given idea for organic farming. If for instance, a survey reveals that the call centres which are catering to the international clients are facing problems because of different accents like French, Italian American, a consultancy service to update employees of call centres through training in pronunciation may become a successful project. Similarly, if the market demands more of cheap detergent cakes, it will be a good opening for small-scale entrepreneurs. Though we are looking at market-driven ideas as an important field of entrepreneurial ideas, we should remember that market would always exert its influence on all enterprises. So entrepreneurs in all sectors have to be always knowledgeable about market dynamics.

d) Trading related ideas

Trading these days is not limited to ordinary grocers or distributor outlets. With increasing consumerism, the scope and nature of trade has enlarged; local trade, imports and exports, e-commerce etc. are all making trading a very wide area of enterprise. Trade in simple terms is buying goods and services, and selling them to consumers at a profit. One big advantage that trading has over other types of business is that it is easier to launch and less risky.

It is, however, necessary for a prospective trader to be aware of the trends in an economy. With the opening of the market to international companies, large size departmental stores, chain shops and umbrella markets have become ubiquitous – competition has become intense and to survive in the market new entrants will have to acquire skills, competencies and knowledge required to launch, manage and expand business opportunities. The basic concept, as we have already seen, is that if a business is to be successful, it must satisfy a need of enough consumers. A trade that is

based on this concept is more likely to be successful than a trade that is launched without adequately studying the consumer needs.

e) Service sector ideas

What is the difference between entrepreneurs and employees? We have already examined this issue. Most of the people seek jobs to earn a living. They work for someone else and get salary or wage for their services. Such people are called employees. Entrepreneurs, on the other hand, are both owners and employees. So, when we talk about service sector ideas we should bear in mind this difference. We are not considering different options in service sector to launch a business venture that involves sale of services for a profit. The entrepreneur himself may provide the service sold or he may provide it through his employees. The key element is that he owns the enterprise and is hence ultimately responsible for its success or failure.

As said earlier, entrepreneurial opportunities are not restricted only to the manufacturing field. Service sector is the most growing field these days the world over, thanks to emerging knowledge societies and advances in information technology. Understanding the linkages to different business activities can identify so many new opportunities. For instance, with the existing industrial enterprises we can think of several service-based units like transport, workshop, painting, maintenance, security, catering, recruitment, training, communication etc. Similarly we can get ideas about linkages with commercial establishments like photocopy, courier service, printing, book-keeping, computer centre, telecom centre, advertisement etc. Many services that have the purpose of helping establishments satisfy their day to day needs like bill collection, water supply, water tank cleaning, travel arrangements, repair and maintenance etc. They can provide many useful options for prospective entrepreneurs.

1.7.2 Creating Efforts

We have understood that creativity is an important and key component of the talents and abilities needed for an entrepreneur. Apart from applying creativity to spot and harness opportunities, it can also be applied to develop new products and services. Such a function is often called inventive entrepreneurship. In a sense this field of opportunities overlaps with all other fields. There are basically five ways in which creative ideas can be generated:

1. Develop a new product or service.
2. Improve an existing product or service.
3. Find a new process or resource for manufacturing a product.
4. Find a new use for a product or service.
5. Find new markets for existing products or services.

A very useful concept to bear in mind is that most often creative products and services are born as a result of problem solving. Someone found that while tightening screws on fixtures, over tightening often resulted in damage to the fixtures. Here was a problem and the solution came in the form of a self-adjusting screwdriver, which prevented over tightening. Similarly when doctors found the monitoring of dosage of medicine to be administered to patients on a regular basis through the traditional method using a syringe cumbersome, a pharmaceutical firm developed a new process of implanting the required medicine in the patient for constant discharge of regulated and

required dosage into the blood stream. When Israeli farmers faced the problem of raising fruit trees in arid and semi-arid conditions, they developed the now much-in-use drip irrigation system. An enterprising villager in our country adopted this system extensively to produce record yields on farms.

Another type of invention is to produce something completely new like computer, television etc. Even if an entrepreneur does not invent a product or service himself, he can spot good inventions, buy the rights, manufacture the product and sell it. We have already seen an example of this kind of opportunity in Trever Baylis clock-work powered portable radio.

1.7.3 SWOT Analysis

Once an idea for a business gets generated, it is important for an entrepreneur to go in for a SWOT Analysis about the idea. This is important as it helps the entrepreneur to make a feasibility study before starting the business. This is crucial and important.

Let us understand from a case study how a business opportunity can further be analyzed for making a final decision. Read the case and try to do the following exercise.

Check Your Progress Exercise 1



- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

CASE STUDY

The Pickle Maker

Ramvati hailed from a village of Uttar Pradesh and was married to Sanatan of Rajasthan. Ramvati always wanted to do some work and earn money to increase the family income. After seeing the women in her village mostly engaged in some activity or the other, Ramvati also thought of making pickle and selling it to the market. She thought it would be a good idea as she knew how to make good and tasty pickle and moreover, she need not have to go out of her house to make it. She may not need to invest a lot of money and the technique needed for making pickle was also very simple.

There was a potential market nearby her village and she thought that her pickle could be sold there. She felt that she should brand the product (like Ramvati Pickle) so that selling becomes easy and fast. She also found out that people in the town and nearby villages use lot of pickle as a regular food habit. She thought she can make a variety of pickles to suit different customers taste – “extra spices”, “sweet pickle” and “pickle of various vegetables”. However, Ramvati realized that the raw materials needed for making pickles are mostly seasonal and therefore, she needs to have a large stock. There was also a problem as pickle can be spoiled if not prepared properly. It has to be consumed very fast. Her husband Sanatan also told her that she needs to go for a licence as it is a food item. Ramvati thought she would visit the market and find out something more about the product. She also discovered that there are many women who are making pickles and selling them in the market. She also realized that people who buy pickles mostly go for a brand name which is common and popular. After coming home Ramvati started thinking whether she should go in for pickle making or not!

Try to fill in the following box. Identify the Strengths, Weaknesses, Opportunities and Threats for the Pickle business for advising Ramvati. This is known as SWOT analysis.

SWOT Analysis

| | |
|----------------------|-------------------|
| Strengths | Weaknesses |
| Opportunities | Threats |

Look at the answers at the end of the Unit.

1.8 ENTREPRENEUR AND ECONOMY

The growth of economy in any country is largely dependent on its people and these people are using resources for a productive purpose. The entrepreneur is an economic leaders. According to Joseph Schumpeter, who regarded entrepreneur basically as an innovator who carries out new combinations to initiate and accelerate the process of economic development, Innovation may assume the following forms :

- i) Introduction of new goods;
- ii) Introduction of new methods of production;
- iii) Opening of a new market;
- iv) Conquest of new source of raw materials or half manufactured goods; and
- v) Carrying of new organization of any industry.

The innovator differs from the manager of a firm who runs the business on established lines. The entrepreneur is the engineer of change, not its product. Profits are the premiums for innovation and continue only when one keeps one step ahead of rivals with innovations.

Schumpeter’s theory is based on certain assumptions like existence of capitalist society with private property, private initiative, money and banking system, etc. The applicability of this theory is doubtful in under-developed countries where the poor infrastructure and lack of capital may block the innovativeness. In such countries even imitator entrepreneurs have a distinct

role to play. Such entrepreneurs provide a fillip to the process of economic growth by adopting business practices already discovered and applied. They reduce the shortage of goods and services and create additional jobs for the unemployed.

India is a country where entrepreneurial initiatives are now encouraged. There are lots of institutions, Organisations, both technical and non-technical, are giving training to young people to become entrepreneurs and create job opportunities for others. So, why not become an entrepreneur to bring a positive change to the society.

1.9 FOOD PROCESSING BUSINESS

In order to understand what it means to be self-employed in food processing, let us see what one needs to know and needs to do.

Food processing business has to consider the availability of raw material, quality, packaging, and preferences of consumers. Generally, we all prepare food at home, and also make food items, which are preserved for a long time. In rural and urban areas, men and mostly women make dried, fermented, and fried products for their family consumption. Adding some skill and knowledge of preservation, anyone can start a business in food items.

It is important to have an idea of

First

- Where one could get trained in food processing
- Where one could get training in business management.
- Where one could get awareness business aspects of the project.

Second

- Raw materials
- Availability of raw material in local market
- Availability of the raw material outside local market
- Price
- Transport
- Equipment

Third

- Packaging
- Type of packaging
- Attractive labelling

Fourth

- Storage
- Preservatives
- Space

Fifth

- Marketing the Product
- Distribution
- Publicity

Sixth

- Preparation of Project report
- Arranging Finance



Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

SENTENCE COMPLETION TEST

Tick any one

1. To succeed in life, one needs
 - a) money
 - b) friends
 - c) self-confidence
 - d) good luck
 - e) skill
2. If there is a good demand, it requires to earn in business
 - a) proper instructions
 - b) quality product
 - c) intensive and good advertisements
 - d) capacity to store goods
 - e) own control over market
3. My main aim in running industry should be
 - a) to keep workers happy
 - b) to earn good profit
 - c) to improve quality of products
 - d) to remain undisturbed by strikes and unrest
 - e) to work hard
4. To continue progress, it require
 - a) hard work
 - b) new and progressive ideas
 - c) honesty and trustworthiness
 - d) education
 - e) systematic and though work
5. He became a successful industrialist because
 - a) he knows how to maintain relations
 - b) he has dependable friends and relatives
 - c) he has vision and enterprising nature
 - d) market fluctuations were favourable to him
 - e) he is a gentleman and a good businessman

6. I want to start a new business because
- I should earn
 - I would be popular in society
 - I want to do something new
 - The state wishes that we should do something
 - I want to serve my caste and society
7. Slow economic progress of the country is because of
- Faulty policies of the government
 - Lack of good facilities
 - Lack of someness venture
 - Labour unrest
 - Lack of increasing opportunities
8. If I will face difficulties in my work, then
- I will leave it and will start a new work
 - I will take advice of known and proper person
 - I will think why it happened, and then again will work with new Enthusiasm
 - I will blame my colleagues
 - I will blame my self
9. If business fails or there is a loss, then
- I shall try to pay less tax to reduce the loss
 - I will accept it with sportsmanship and try again
 - I will sell goods at cheaper price so that everything is sold out
 - I will join with somebody in partnership
 - I will try to find out who is responsible for the failure

1.10 LET US SUM UP



Deciding a career is important. However, there are lots in benefits in becoming a self-employed person. It generates income and this is responsible for livelihood. It helps to be innovative and growth-oriented. The growth in a self-employed situation reflects certain entrepreneurial behaviour. In this process, an individual learns to imbibe many entrepreneurial qualities and to acquire certain entrepreneurial skills.

‘Risk’ is inevitable in the life of an entrepreneur “Risk” in other words refers to challenges but the risk taken by an entrepreneur has to be moderate and calculated. However, entrepreneur’s risk is different from gambler’s risk although gambler also undertakes risk. But remember that an entrepreneur depends on “effort” for the outcome, while the gambler depends on “chance”.

The success of an entrepreneur depends upon the goal setting with a hope of success. This leads to stretching to one’s own capacity. The capacity would include how one senses opportunity. The sensing of opportunity involves understanding problems in the environment, and identifying a solution, think about ideas, products and services. All opportunities have to be analyzed through SWOT analysis. The feasibility of a business can only be understood through that process.

Becoming an entrepreneur also means a contribution to the economy of a country through new products, new methods, new markets, and new sources of material. This involves innovations. However, in a developing country like India “imitators” can also be entrepreneurs.

1.11 KEY WORDS

| | | |
|-------------------------------|---|--|
| Accelerate | : | Begin to move more quickly |
| Attainment | : | Success in accomplishing |
| Conquest | : | The action of conquering |
| Distinct | : | Recognizably different in nature |
| Gambler’s risk | : | primarily concerned with the” pay off” which is solely determined by the result of a “chance”. |
| Imitator | : | Copier of a model |
| Inclination | : | Natural tendency or urge to act or feel in a particular way |
| Innovate | : | Make changes in something already existing |
| Oriented | : | To direct towards |
| SWOT | : | A process through which the feasibility of a project/business idea is assessed |
| Sensing of opportunity | : | understanding problems in the environment, and identifying a solution, thinking ideas, products, services. |



1.12 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

CASE STUDY

SWOT Analysis Chart

| | |
|--|--|
| Strengths | Weakness |
| <ul style="list-style-type: none"> • The Pickle can be made tasty • Low investment • Skills easily available • Simple technology | <ul style="list-style-type: none"> • Seasonality of raw materials (needing large stocks) • Product is perishable • Licensing formalities are cumbersome |
| Opportunity | Threats |
| <ul style="list-style-type: none"> • Large Market • Brand selling possible • Variety could be made to suit customers ‘Tastes’ | <ul style="list-style-type: none"> • Large no. of competitors • Establishing brand is difficult • Customer tastes may change |

Remember that Weakness can be converted into Strengths and Threats can be converted into Opportunities

Check Your Progress Exercise 2

GET YOUR SCORES FOR SENTENCE COMPLETION TEST

1. To succeed in life, one needs: self-confidence (c)
2. If there is a good demand, it requires: Quality Product (b) to earn in business.
3. My main aim in running industry should be to earn good profit (b)
4. To continue progress, it requires new and progressive ideas (b)
5. He became successful industrialist because he had vision and enterprising nature (c)
6. I want to start new business because I should earn (a)
7. Slow economic progress of country is because of lack of someness venture (c)
8. If I will face difficulties in my work, then I will take advice of known and proper persons (b)
9. If business fails or there is loss then I will accept it with sportsmanship and try again (b)

Make a total of the statements tick marked in the answer sheet by you. Then follow the table given under for final scoring.

| <u>Table</u> | | |
|--------------|---|---------|
| 0 – 3 | = | 1 mark |
| 4 – 6 | = | 2 mark |
| 7 – 9 | = | 3 marks |

Note: If your scoring is in category 7-9 you get 3 marks: **It suggests that your understanding about entrepreneur and entrepreneurship is towards right direction.**

If your scoring is in category of 4 to 6 you get 2 marks: **It indicates medium score.**

If your scoring is in category of 0 to 3 you get 1 mark: **It is a low score.**

In order to improve the score read lot about entrepreneurs, try to meet them, watch Television programmes on them. Try to locate new food products in the market. Try to find their source.

1.13 SOME USEFUL BOOKS

1. Akhouri, Mishra; Sengupta. R. (1999) Trainers Manual on Developing Entrepreneurial Motivation Published by NIESBUD.
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UNIT 2 ENTREPRENEURIAL SKILLS

Structure

- 2.0 Objectives
- 2.1 Introduction
- 2.2 The Joy of being an Entrepreneur
- 2.3 What is required to be an Entrepreneur?
- 2.4 Concept of Entrepreneurial Skill
 - Entrepreneurial Value, Attitude and Motivation
 - The Work Ethics
- 2.5 Understanding Entrepreneurial Skills
- 2.6 Let Us Sum Up
- 2.7 Key Words
- 2.8 Answers to Check Your Progress Exercises
- 2.9 Some Useful Books

2.0 OBJECTIVES

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

- appreciate the requirement of becoming an entrepreneur;
- explain the concept of entrepreneurial skills;
- describe entrepreneurial values, attitude and motivation; and
- state various entrepreneurial skills.

2.1 INTRODUCTION

Entrepreneurship is the quality and skill required to become an entrepreneur. It refers to identifying and innovating ideas and services; mobilizing resources; organizing production and services; and finally marketing them, covering the risk by constantly trying for growth and development.

In this unit we will try to understand the concept of entrepreneurial skill and different skills that an entrepreneur needs to develop.

2.2 THE JOY OF BEING AN ENTREPRENEUR

In the previous Unit you have understood who an entrepreneur is. However, let us also understand the joy that a person gets after becoming an entrepreneur. In entrepreneurship the individual is the most important element. He/she takes a decision to start an enterprise and strives to make it a success. In this process, it is an experience of challenge, joy as well as fulfilment. Let us look at the reasons why this is an experience of fulfilment.

- An entrepreneur is an independent being; entrepreneurship provides an opportunity for self-expression and the realization of one's passion for doing something new and different – a scope for innovation.
- There are numerous opportunities for self-development.
- An entrepreneur makes his/her own decisions and acts on them.

Entrepreneur and Entrepreneurship

- Working on one's own and thus getting rewards yields immense satisfaction and pleasure for more than what one can get in a job.
- Monetary rewards can be more than commensurate with one's capacity, capabilities and work.
- An entrepreneur with a science and technology background can introduce new technologies, develop substitutes for imported components.
- An entrepreneur generates employment for others.
- An entrepreneur can make significant contributions to the development of the country.
- An entrepreneur can be doubly fulfilled. He/She realizes both goals, of individual success as well as of contribution to society.
- Above all he/she can be an achiever, realize his/her goals and prove his/her one's achievements to the world.

The following example shows how a person with determination and strong desire to be on his own can become an entrepreneur and be successful:

Balachandran was born in a lower middle class family of Madurai. He completed his graduation in commerce by attending evening classes and doing part-time jobs during the day. Later, he worked as a part-time accountant and also became an insurance agent. He left this job due to some problems and enrolled himself in a post-graduate course in Commerce. But his heart was not really in it. It was at this time that he came across an advertisement for an Entrepreneurship Development Programme (EDP) to be organized by ITCOT (Industrial and Technical Consultancy Organization of Tamilnadu Ltd.) He applied for participation in the same and was selected. During the EDP he identified a project, but could not mobilize the financial resources needed. However, he was determined to set up his own industry and with this objective he left for Chennai in 1988 with just Rs. 500 in his pocket.

He was unfamiliar with that city, but somehow found an inexpensive place to stay. In order to survive, the first priority was to earn some money. With some knowledge about the market for used cartons, he purchased used empty cartons at a cheap rate from liquor shops and sold them. This went on for some time; then through a friend he got a job, as an assistant to a commercial artist, which paid him Rs. 300 per month.

But his ultimate aim was to establish his own enterprise. So before joining he tried to find out whether a job would provide him experience, which could help him, set up his own enterprise. When he found that there was a good market for advertising, he joined. His job was to procure orders for the artist and on the very second day of his employment, he procured a very large order. But his salary was too small to survive on, so he procured small orders for himself on the side and executed them. Very soon, dissatisfied with his salary he took up another job with a liquor company inspecting liquor shops, but continued with his work for advertising companies. And when he felt that he had enough work to survive on, he resigned his job.

In December 1988, with a sum of Rs. 24,000 borrowed from his brother-in-law, he was finally able to launch his own advertising enterprise in rented premises. The first order was from Kquality Ice Cream. Working capital was a problem, but with persistence he obtained Rs. 5,000 from a bank. Fortunately the machinery and equipment required were few and not very expensive, so he had some money left over for the working capital. The business grew steadily.

By 1990, he had diversified into acrylic glow sign boards and was executing orders for big companies like Cadbury's, Kquality Ice Cream, etc.

He thus grew steadily, took more loans from banks, diversified into name plates, menu boards, engraved works, screen-printing and bulk order paintings.

From humble beginnings, step-by-step, with hard work and perseverance, today he is an entrepreneur with a turnover in lakhs. Two years ago he launched a confectionery unit. But the story does not end there for Balachandran. He has ambitious plans for setting up other industries too, and with his skills and motivation, he is bound to succeed and realize all his dreams.

So, does this case motivate you to become an entrepreneur?

Check Your Progress Exercise 1



- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

Tick the right answer

1. Do you feel motivated? ... (Y/N)
 2. Do you sincerely believe that you have to work hard? ... (Y/N)
 3. Can you identify some entrepreneurs, from your surroundings, who are reaping the fruits of their labour? ... (Y/N)
 4. Do you put your belief into action? ... (Y/N)
 5. Can you identify the types of work you have to do? ... (Y/N) List them.
 6. Can you work for long without getting tired or bored? ... (Y/N)
 7. If the answer is 'NO' to 7, have you adopted any strategy to improve it? ... (Y/N)
 8. Is your work related to the attainment of your goal? ... (Y/N)
 9. Do you call yourself a hard worker? ... (Y/N)
 10. If 'Yes' to 9, do you have reasons for thinking so? (Y/N) Write down the reasons.
 11. Is there any gap between how you want to pass a day and how you actually do it? ... (Y/N)
 12. Have you mastered the play theory of work? ... (Y/N)
 13. If 'Yes' to 14, do you have any concrete evidence? (Y/N) list out the evidence.
-

2.3 WHAT IS REQUIRED TO BE AN ENTREPRENEUR?

Once you are motivated you will start your business. It is often said that in order to start a business one needs to have three things: knowledge, attitude and skills. For example, if a person wants to start a fruit juice corner, he should have proper knowledge about “processes” involved in fruit juice making. What kind of fruits make juice, in what season, which fruits are available etc. are the knowledge part. Apart from this the skill to prepare fruit juice, using machinery etc. is important, this is the skill part. To prepare oneself, to ‘Be’ a fruit juice stall owner, to have the right mind set and willingness to be independent and value each and every job involved in this business. This is referred to as attitude.

It is the attitude that matters

Why is it so? There is nothing wrong with rummy or any other thing. The difference lies in the attitude of the players. You associated the idea of boredom with rummy because you learnt to hate it; others associated it with pleasure as they learnt to love it.

It is implying this. Turn the switch in your mind. The boring job turns out to be the most interesting: Change! Does it come easy? With time, anybody can change. Given the will, you too can change!

You have to change your attitude. You have to find interest in your work – whatever you are called upon to do. It is all because you have not got used to it at all. That is why it is wasted. Start using it and interest will develop.

Right now start finding your work interesting and enjoyable. No matter if it does not seem to be so. You simply start thinking it is wonderful. You know that drops of water wear away the hardest of stone. Likewise, each day of your practice will carry you closer to your goal.

Every day, while you work, try to visualize the goal you are striving for. Each spell of work will take it nearer to its fruition. The intensity of your desire should be so strong that it will take away all the rigours of your so-called hard work. Then it will turn into mere play and sheer fun. Imagine, feel and experience that fun, that joy!

Make work fun!

Believe that you can do it!

Start doing it right now!

Brush aside the initial difficulty, if any!

Create enough zeal and enthusiasm for your work!

Each day, conquer it with greater determination!

A simple book on ‘Yogic exercises’ warns the beginners: “In the beginning, you will not be able to perform some of the poses perfectly. Regular practice for some days will bring perfection. Patience and perseverance, earnestness and sincerity, are needed.”

Contd...

We interviewed a circus star. Since childhood, she had put in many years of strenuous practice. It took time, patience and devotion to achieve perfection. Practice makes for perfection.

Entrepreneurs who are already successful, about whom you hear or read stories, benefited from many years of informal training. Real education does not necessarily mean university education, alone.

These many years of informal training you do not have. And in your case, it is this training we are going to replace with a compressed course. Naturally, you can imagine the importance of following each instruction faithfully, as well as the amount of work you have to do in order to obtain the desired result in the shortest possible time.

There is another difference. Our entrepreneurs had their informal training in its most natural form, whereas you have to be deliberately induced into it. Therefore, quite possibly, you may have to exert a lot more than they did.

That is why it is all the more important that you should turn the tedious task of exertion into an interesting play. Obviously it has other benefits as well. That way, you will learn better and quicker. It should provide an ideal substitute for another man's informal training.

2.4 CONCEPT OF ENTREPRENEURIAL SKILLS

If you decide to become an entrepreneur, it is natural that you need to develop certain entrepreneurial skills to translate your dreams into action. What are these skills and how they are developed are certain questions that might bother you. However, we will first try to understand entrepreneurial skills.

Entrepreneurial skills refer to the ability and the capability of an entrepreneur to initiate, launch and sustain the process of enterprise building. These skills are not necessarily born but can be developed.

However, these entrepreneurial skills are the result of certain set of values, attitudes and motivation.

2.4.1 Entrepreneurial Values Attitudes and Motivation

Values

Values refer to one's own belief towards life in general. It helps an individual to focus towards goal. However, some of the entrepreneurial values are as under:

- Innovativeness
- Independence
- Seeking Perfection, and
- Respect for work

Attitudes

Attitude refers to one's own in born and developed tendency to think and act in a particular way. The entrepreneurial attitudes are:

- To use imagination/intuition
- To take moderate risk
- To enjoy freedom of expression & action
- To look for economic opportunities
- To find satisfaction from successful completion of tasks
- To believe that one can change the environment
- To take initiative
- To analyse situation & Plan Action
- To involve in work

Motivation

Motivation is generally understood as the driving force towards the attainment of the goal. Because of certain entrepreneurial values and attitudes specific motivations get developed within a person. Such as:

- Constantly striving for success in attaining certain standard of excellence.
- Desire to set some standard and to excel it.
- Need to excel the standard already set by others.
- Concern for achieving something unique.
- Urge to succeed in achieving long-term career goals.
- Need to influence environment, individuals & situation for achieving set goals.

In the next unit you will know more about Motivation with particular reference to Achievement Motivation.

2.4.2 The Work Ethics

The Primary Motive of an entrepreneur is related to his/her work or task and therefore, the basic philosophy of work is important for an entrepreneur. Let us understand about the work ethics.

Who works? The man who has a need. Everybody in the world from a Sadhu and a politician down to the writer, builder and carpenter, and whosoever, works with a motive. There is no work without a motive. Not even the so-called “nishkama karma”. However, motives differ from man to man. A sadhu has a motive different from that of a politician.

We are mainly concerned with economic motives. We are interested in economic wants and our work is economically directed towards productivity, prosperity and plenty.

Want, necessity, need or desire – whatever you may call it – is the great force behind all human motivation. No skyscraper would have been built, nor better living conditions created, had there been no felt-need.

Needs may arise because of:

- a) a desire for material gain;
- b) a desire for winning love;
- c) a desire for gaining a sense of freedom and power;
- d) a desire to be better than your neighbour;
- e) a desire for social and national service;
- f) a desire for self-expression and recognition.

Identify the ground (or grounds) for your need. Specify them. This will serve as your motivators.

The biggest source of energy – far greater than all potential sources of energy combined together – mankind could so far find, is the desire of the human heart. It fuels the gigantic engine of progress. Any man fuelled by the fire of desire moves to ever greater achievement. The man devoid of the fire of desire rots in the same groove he was born.

Invent your necessity

Invention is not first. Necessity is the first. And desire comes ahead of development.

In order to rise higher, to achieve greater success, develop your fuel first. Before you build anything, build up as your desire.

L.N. Kirloskar was a petty drawing instructor at Victoria Jubilee Technical Institute (VJTI), Bombay. Since the time of Kirloskar, if not earlier, many such drawing instructors retired from service and died as drawing instructors. At present, a few hundreds, if not more, such instructors are serving in different institutions in the country. Probably they too will retire and die as drawing instructors.

But Kirloskar did not retire as a drawing instructor. And he did not die too as one because he had the courage to desire something much more than the pittance he was getting at VJTI. He had a dream to fulfil. He had the will to work for it. As a result he died as a renowned industrialist. Remember, today's conditions are much better than those in Kirloskar's time.

Y.R. Nanda was a small-time trucker. He fell in love with a girl named Dolly. She told her young fiancé in plain terms that she would never marry a truck driver'. Nanda set up Escorts Limited in 1949 in order to win his fair lady's hand. This is no fairy tale. It is a true story.

It does not matter what you are at present. It matters what you want to be.

Spell out your wants, necessities and desires. Make them strong and intense. If you are armed with a burning desire, only then will you be able to work wholeheartedly with a tenacious singleness of purpose, and win. The stronger the desire, the higher you will reach.

2.5 UNDERSTANDING ENTREPRENEURIAL SKILLS

In order to initiate, launch and manage the enterprise, the entrepreneur is motivated to imbibe certain skills. Let us try to understand these skills, which are important for success.

Positive self concept

An achiever directs his energies towards accomplishment of worthwhile goals and sets standards of excellence in what he is doing. This is based upon the awareness of his strengths and weaknesses. He uses positive knowledge to support his thinking. He is rarely negative. He has self-confidence.

No entrepreneur has all these qualities. But most of them possess at least some of them. So the first step for a person aspiring to entrepreneurship is to make

an inventory of the traits he possesses. This self-awareness analysis will help define your strengths and overcome your weaknesses.

Creativity and innovation

The anchor of an entrepreneur's career is creativity and innovation. Innovation is the process of applying "**new knowledge**" to practical use. It does not necessarily mean trying new ideas for the first time but it also means applying the same or a similar idea at different places or in new settings. As an entrepreneur you may have to develop the quality of picking up new ideas and adopting them faster than others.

Risk taking

Many of us have new ideas, knowledge and resources. But we do not start an enterprise because we lack the quality to take risk involved in it. As an entrepreneur you have to develop faith. No venture is possible without certain amount of risk. An entrepreneur assesses the risk and favours taking calculated moderate risk (neither very high nor very low). Risk means stretching ones own capacity where the chance of success is greater than the chance of failure.

Using feedback

Entrepreneurs like to have immediate feedback on their performance. They seek prompt and accurate data, and it does not make any difference whether or not the information they get is favourable. In fact, they are stimulated by unfavourable feedback into pouring more energy into attaining their objectives.

Opportunity seeking

Common people just wait for opportunities to come along. Majority does not even recognize opportunities until these become obvious. An entrepreneur actively looks for, seeks, recognizes or creates business opportunities even under crisis.

Information seeking

Seeking relevant and precise information is important for success. It enables you to take risk, helps improve the quality of decision that you make and provides basis for efficient management. An entrepreneur inculcates the habit of gathering information from all sources and considers expenses for seeking information as investment.

Being high achiever, an entrepreneur has ability for seeking and using feedback about his own performance. Based on the feedback, the person mends his ways. Often money (profit or loss) is an indicator of the performance.

Concern for standard/quality of work

The concern for excellence is the key quality of an entrepreneur. By attaining certain standard of excellence in his work, and proving his worth he gets satisfaction. Sub-standard performance is not acceptable to him. The standard of work performance is not limited to products and services, but extends to efficiency, to do things better, faster, with fewer resources.

Problem solving orientation

One of the important entrepreneurial qualities is the problem-solving orientation. While pursuing any business goal, an entrepreneur makes the basic assumption that problems are bound to be there. As a matter of fact, he believes that real pleasure comes in solving these problems. Accordingly, entrepreneurs develop a lifestyle of solving problems.

Faith in planning

To be a successful entrepreneur you need to develop skill in planning and a firm faith that planning is a must for successful completion of any task. You develop and use logical step-by-step plans to reach your goal. Through planning an entrepreneur prevents the wastage of scarce resources, ensures success by anticipating possible hurdles, locates new sources of help and resorts to alternative activities to reach the goal.

Persuasive and influencing quality

One of the important functions is to influence the environment comprising individuals and institutions for mobilizing resources, procuring information, organizing production/services and marketing your products and services. For all these you need to develop skills and attitude for persuading, influencing and convincing others.

Long term commitment

This is one of those characteristics, which distinguish you as an entrepreneur, as the creator and builder of an enterprise from the promoter of quick money. The commitment to a long-term entrepreneurial goal helps an individual to give highest priority to getting jobs completed.

Coping with stress

As a central figure in your enterprise, you will have to cope with many situations at the same time and make the right decisions, which may involve a lot of physical and emotional stress. All this can be done, if you have the capacity to work long hours and keep cool under a lot of tension.

Check Your Progress Exercise 2



- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

CASE STUDY

Let us study the case of Ajay. Can you list out some of the qualities in him which have made him a successful entrepreneur.

Story of Ajay

Ajay after his higher secondary started working in a Private Company. However, he nurtured a dream to have his own enterprise. The training during November, 2001 in an EDP on Food Processing organized by a consultancy organization helped his dream to be come true with the aid of Cooperative Agricultural and Rural Development Bank Ltd. Ajay set up his enterprise “DELICIOUS” Food products in December 2001 at village Hariharpur,

(Midnapore). However, like any other entrepreneur, he had initial difficulties in launching the enterprise. This process made him strong and determined and he was able to start the enterprise with an initial investment of Rs. 2 lacs with a matching loan of Rs. 2.50 lacs. He collected information about a machine developed by IIT Kharagpur at the Department of Food and Technology; this was a motorized oil-extracting machine, which he felt would help him to create a healthy snack item. The capacity per day of this machine was 300 kgs. He purchased the raw material from the wholesale market of Kolkata as quality and cost effectiveness were his prime concern.

The food item that he produced got picked up by the market and within a period of 2 years, the unit could establish its identity and reputation. For Ajay there was no looking back and he expanded his market to Bihar and Orissa, apart from the local market and identified about 26 distributors with 19 full time workers. As time passed, Ajay expanded his business and identified more snack items. After a training program in March 2002 by the KVIC, he decided to diversify his business. His colleague Vipin, a Food Processing Expert of Kolkata helped him to add value to his product.

At the present moment Ajay is happy with his reputation in the market but the fund flow and cash liquidity is not helping him to fulfil his next dream. He is aware that these are the problems of any business when it grows and he has to persevere.

Ajay is ready with his new venture of starting a unit of grinding mill with Vipin as his partner. The Bank is ready to finance the Project but is insisting on a market study done by an established organization. The dilemma at this stage for him is whether to invest money on a Market Study or to concentrate on present business. He strongly feels that this consultancy organization being the Promoter of his initiative should give him concession in consultation charges. The journey to becoming an entrepreneur has made him tough and he is open for negotiation.

Perhaps it is time for Ajay to consolidate his business strategy and review the marketing expansion for his principal business. For an established entrepreneur nothing comes free, but perseverance is tested.

(Case extracted from a report of NIESBUD)

In case you have identified a few skills in Ajay, Check the same with the answers given at the end of the Unit.



Check Your Progress Exercise 3

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

“Entrepreneurial Skill Assessment Quiz”

This quiz is designed to determine the latent skills in you. Read each question and respond by indicating ‘T’ for true or ‘F’ for false. Give your immediate reaction. Be completely honest so that the quiz will really be useful to you. Complete the quiz in one sitting free from distractions.

True/False

Entrepreneurial Skills

- 1. When faced with a problem, I always find a new way of overcoming it _____
- 2. When a decision has to be made, I can make it easily even though I am not sure of the outcome _____
- 3. I have a strong need for social interaction _____
- 4. After learning how to do something right the first time, I don't change my approach _____
- 5. I have a plan where I want to be financially ten years from now _____
- 6. When I am placed in a new situation at work I quickly sort out what needs to be done _____
- 7. I see potential problems as challenges _____
- 8. Constantly having to deal with problems wears me down _____
- 9. I revise my goals from time to time in the light of changing situations _____
- 10. It is important for me to know that I have a dependable income _____
- 11. When I am dealing with a problem, I tend to get struck easily _____
- 12. If I were laid off, I know I could find some other source of income _____
- 13. I thrive on the challenge of solving different problems _____
- 14. I don't enjoy being directed by others _____
- 15. I take courses on how to improve what I do _____
- 16. Once I've met a challenge I am usually satisfied and don't need to look for an other project _____
- 17. I normally start off my day with a list of things to do _____
- 18. I don't enjoy working alone _____
- 19. The fear of losing my job causes me great apprehension _____
- 20. I am not good at dealing with a multitude of problems at the same time _____

21. I consider myself to be very resourceful in tight situations _____
22. I usually have a plan of action before starting a project _____
23. I am good at finding creative ways of solving problems _____
24. The idea of being my own boss appeals to me _____
25. At times, I don't feel completely comfortable with myself _____
26. I worry about what will happen if my plans
to do not work out _____
27. When I come up against un-expected obstacles,
I prefer not to continue _____
28. I have a strong desire to improve myself in
everything I do _____
29. I read books on how to achieve success _____
30. I need to keep taking on challenges and feeling myself
overcoming them _____
31. I think of a glass as being half-empty rather than half full _____
32. I get disappointed when things do not go my way _____
33. I believe in the saying "If anything can go wrong, it will" _____
34. My friends would call me an optimist _____
35. I always look at the bright side of the life _____



2.6 LET US SUM UP

Most individuals are looking for many things when they venture out on their own. Some of the charms of becoming an entrepreneur are:

- Opportunity to gain control over your own destiny
- Opportunity to realize your full potential
- Opportunity to reap unlimited profits
- Opportunity to contribute to society and be recognized for your efforts.

To become successful as an entrepreneur, one needs to have specific skills. These skills get developed in a person by certain set of values, attitudes and motivation. Values are certain beliefs, which give direction. Attitudes are defined as certain tendencies to act. Motivation is the driving force, which helps an individual to acquire certain skills, which are functional, and helps the individual to perform.

The entrepreneurial skills are important as they help the person to prepare himself for the external environment. These skills can be learnt and can be developed through proper training and interventions. Some of the skills are

important to launch any business whereas some are important to manage the enterprise. or example seeking and using feedback, concern for standard/ quality work, problem solving orientation, persuasive and influencing talents are very important in sustaining the entrepreneurial initiative.

2.7 KEY WORDS

| | | |
|--------------------------------|---|---|
| Entrepreneurship | : | The quality and skill required to become an entrepreneur. |
| Entrepreneurial skills: | | The ability and the capability of an entrepreneur to initiate, launch and sustain the process of enterprise building. |
| Values | : | One’s own beliefs towards life in general |
| Attitude | : | One’s own tendency to act towards the goal and direction. |
| Motivation | : | The driving force towards the attainment of the goal. |
| Innovation | : | The process of applying “new knowledge” to practical use. |
| Risk | : | Stretching one’s own capacity where the chance of success is greater than the chance of failure. |
| Persuade | : | Cause another to do or think in a desired way through reasoning or argument. |
| Convince | : | Cause another to believe firmly in the truth of something. |
| Influence | : | The capacity to have an effect on the character or behaviour of someone or something, or the effect itself. |
| Achievement Orientation | : | Desire to do something, which is new or better, and to be the best in competition. |

2.8 ANSWERS TO CHECK YOUR PROGRESS EXERCISES



Check Your Progress Exercise 1

Clues

1. It should be a continuous process.
2. For 2 to 11, 13 and 14, a “Yes” answer indicates good progress.

For 11 and 14, proofs will confirm your ‘Yes’ answer.

Any contradiction among 6, 9, 10, and 11 will indicate that you are not able to judge yourself properly.

‘No’ answer in 12 proves that your action and will are perfectly matched. Your will power is quite strong. Keep it up.

A ‘Yes’ answer to 12, you have to take remedial action for reducing the gap.

Check Your Progress Exercise 2 – Case Study

Story of Ajay

The following qualities\skills have made Ajay an Entrepreneur.

- Having a dream (Achievement Orientation)
- Strong
- Determined
- Hard Working
- Information seeker
- Long-term commitment
- Risk Taker
- Persevering
- Problem Solver
- Planner
- Persuasiveness

Check your Progress Exercise 3 – Self Exercise

Check Your Score

(Tick mark as per your response True\False)

SKILLS

| | |
|----------------------------|--|
| Innovation | 1(T), 4.(F), 11(F), 5(T), 21 (T) |
| Tolerance to Uncertainty | 2(T), 6 (T), 10 (F), 12 (T), 19. (F) |
| Desire for Independence | 3(F), 14 (T), 18 (F), 24 (T), 25 (F) |
| Continuous Goal Setting | 15.(T), 9 (T), 16 (F), 17 (T),, 20 (T) |
| Persistent Problem Solving | 7 (T), 8 (F), 13 (T), 22 (F), 23 (T) |
| Achievement Oriented | 26 (F), 27 (F), 28 (T), 29 (T), 30 (T) |
| Positive Outlook | 31 (F), 32 (T), 33 (F), 34 (T), 35 (T) |

The result

Add up your tick marked scores in each category of skills. The score obtained may help to understand your position & status on different skills. If your score is 5, congratulations!! If your score is less than 3 it suggests that you need improvement in that skill. Find out the way for developing the same. However, the next unit will help you to see the way of developing these skills.

2.9 SOME USEFUL BOOKS

1. Akhouri, Mishra; Sengupta. R. (1999) Trainers Manual on Developing Entrepreneurial Motivation Published by NIESBUD.
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UNIT 3 DEVELOPING ENTREPRENEURIAL SKILL

Structure

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Right Mindset
- 3.3 Strategy to bring Desirable Changes in the ‘Mind Set’ through Training
 - To Know “What You Are?”
 - To Know Your Destination
 - To Believe that You Are the Master of Your Own Destiny
 - To Develop a Positive Self Image
- 3.4 Locus of Control
 - Effort, Performance and Outcome
- 3.5 Achievement Motivation
- 3.6 Achievement Planning and Business Goal
 - How to Plan
 - Feedback
 - Planning a Habit
- 3.6 Let Us Sum Up
- 3.7 Key Words
- 3.8 Answers to Check Your Progress Exercises
- 3.9 Some Useful Books

3.0 OBJECTIVES

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

- explain the stages of developing the mind set for becoming an entrepreneur;
- describe about Locus of Control; and
- state the steps of planning for success.

3.1 INTRODUCTION

As we have understood from our previous units that it is possible to acquire Entrepreneurial skills, in this unit we will understand the process of acquiring them. Remember the saying” GOD help those who help themselves” it holds true in the case of becoming an entrepreneur.

3.2 RIGHT MINDSET

In order to become an Entrepreneur, all you need to develop is the right mindset, the appropriate knowledge and required skill. I am sure you will agree that it is not so difficult to collect information in the era of internet, apart from books and journals, which are the old device. Acquisition of skill related to business function is important and it can be learnt. However what is most crucial in this is to develop a right kind of mindset. Let us look into the following.

3.3 STRATEGY TO BRING DESIRABLE CHANGES IN THE “MIND SET” THROUGH TRAINING

It is possible to bring desirable changes through a purposeful training intervention. We have talked about this in the previous unit. The specialist trainer organizes specialized training. However the major responsibility lies with the learner for this to succeed. The attempt is made to provide an opportunity to explore the “Behaviour “and experiment with new Behaviour conducive to entrepreneurial performance. These lead to getting entry into the process of “self- learning” and “self-acceptance”. Now let us understand this process of change, during training

3.3.1 To Know “What You Are?”

The question could be answered in a variety of ways. One of the ways commonly followed is the attempt to reflect oneself keeping in view the image of an achievement-oriented person. In such a situation it is possible to visualize an “ideal self”; against the “real self” i.e. what is reality or the real image? The gap between the ideal self & the real self sets the Process of change in motion. It is possible to realize the gap and enhance willingness to fill up the gap through action. For example, Raju’s real self is that he hates math’s, but the ideal self is that he wants to become a Chartered Accountant. Now it is for Raju to fill this gap by taking steps.

Let us examine the steps:

- Reviewing one’s failures and successes, fears and aspirations.
- Looking at the relation between one’s own desires and what society. (Family & Culture) expects.
- Examining one’s characteristic modes of behaviour resulting from understanding, attitude, opinions and beliefs.
- Looking at the self through the eyes of others.
- Studying fantasies\dreams and the actual behaviour.
- Identifying the internal potentialities.

3.3.2 To Know Your Destination

Once you know or discover the discrepancy between the ideal and real self it may create enough anxiety or discontentment and you may soon desire to change towards the ideal. This is important, as through discontentment, you may like to find alternative solutions. For this the following aspects may be kept in mind.

- Explore alternate ways of thinking and action and collecting factual information in relation to the consequences of these choices.
- Ensure quick feedback concerning the new Behavioural patterns and understand their significance.
- Evaluate progress in the desired direction.
- Try out the new Behavioural pattern in the real world outside the training experience.

3.3.3 To Believe that You Are The Master of Your Own Destiny

Fundamental to all the other conditions for change is growing conviction in you that you can change, take control and direct your own life. There are

different ways through which any person can realize how powerful he is, rather than a pawn being pushed around by others. Try this simple strategy to bring about:

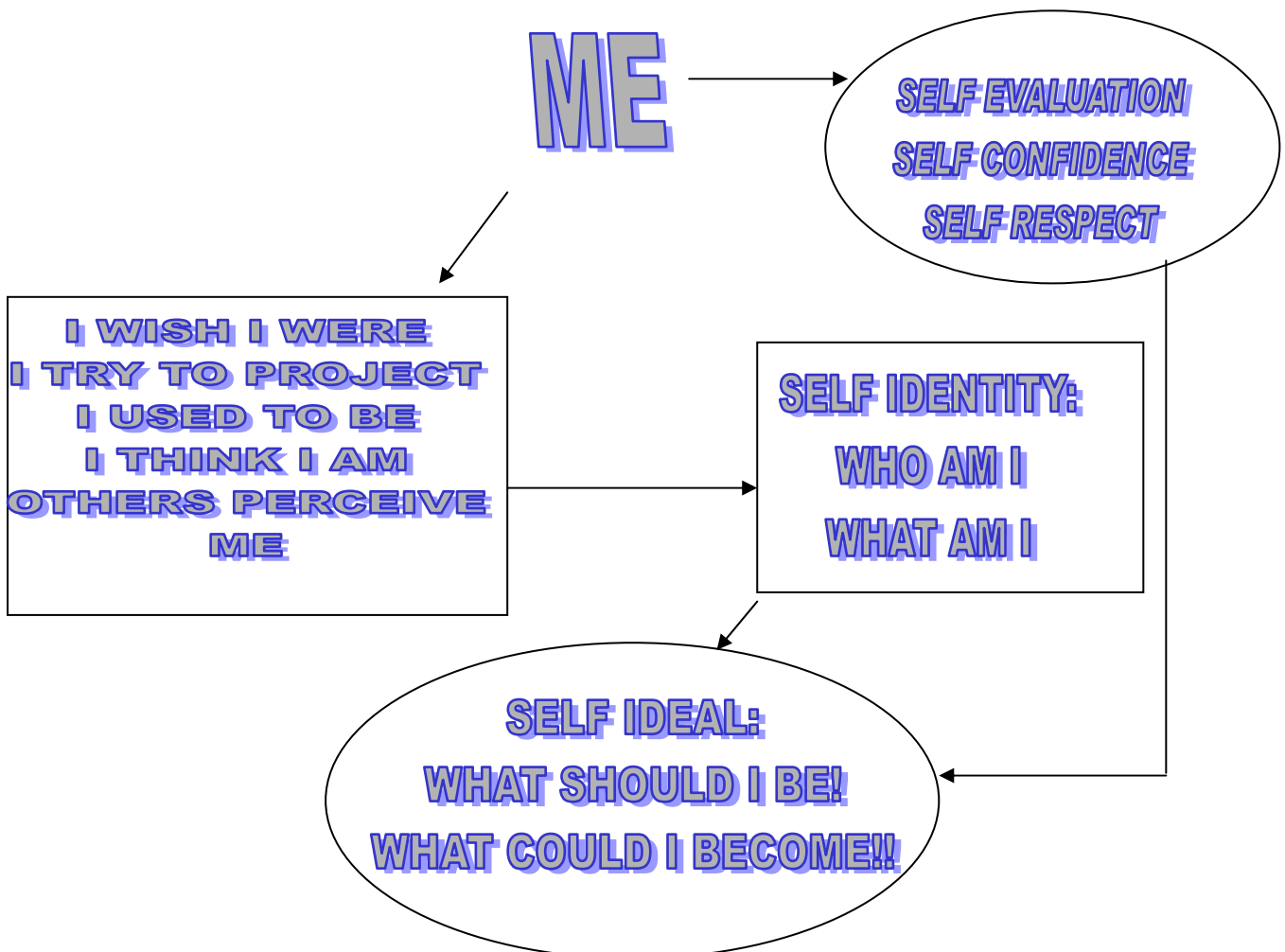
- Have belief in your capacity to help others and to learn from others.
- Have a constant desire to strive for change.
- Take a decision regarding pursuing any change on your own rather than following prescription by others.

These will facilitate your thinking and help you towards building an entrepreneurial profile. Any desirable change in thinking will lead towards actions conducive to entrepreneurial performance.

3.3.4 To Develop a Positive Self Image

In order to develop an image of self, let us look at this diagram. The central focus is ‘ME’. This ‘ME’ is formed on what I think about myself, what I wish to become, how others perceive me and most important how I project myself. Based on this, I develop my own identity of “Who I am”. However, this ME constantly goes through a continuous self-evaluation, which contributes to self-confidence and self-respect. Based on this evaluation the “Ideal self” is formed which helps the person to move forward towards the goal.

Remember this can make a person more focused. This leads to self-effectiveness and increased internal power or control.



Research has shown that a person desiring to be an entrepreneur has a goal where he is continuously engaged in some activity rather than just aiming at a goal where there is a lack of clarity. Further it has been found that such persons have tendency to solve rather than avoiding problems. They possess internal resources in the form of confidence, ability, capacity etc. rather than depending upon external resources or have a feeling of lack of resources. Similarly they are found to take initiative rather than wait for a direction from others to do the task. A content analysis of the essay on “Who I am?” can help in understanding and developing this concept.

3.4 LOCUS OF CONTROL

What is Locus of Control?

It means that the factors responsible for any event or an outcome of any action. The responsibility may be of external factor or internal factor. The internal factor may be under one’s control but the external factor is not within one’s control.

Let us take an example, Ravi has not scored well in his 10th Board exam. This is an event. Now for Ravi, he may justify the outcome in three ways

- a) The paper was tough
- b) I did not prepare properly for the exam
- c) My luck was bad

For the response (a) and (c) the locus of control is **external** and for response (b) the locus of control is **internal**.

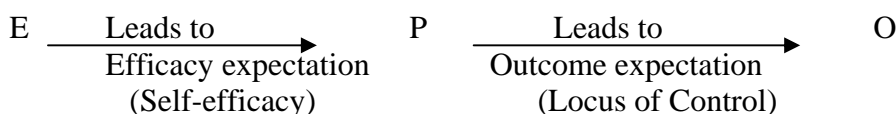
The persons who are more internal are more effective in whatever they do in their lives. They perform better than others as they believe in their own potential.

3.4.1 Effort, Performance and Outcomes

Let us try to understand the diagram further:

The relationship between self-effectiveness and locus of control and their effect on performance may be best summed up in the following diagram:

Effort (E) leads to performance (P), which then leads to outcome (O). An individual's belief that if they exert effort they will succeed, is their self-efficacy. Locus of control on the other hand, is their belief that they can perform in such a way as to achieve the desired outcome



It is possible to assess one’s self-efficacy and plan for necessary changes if required. A simple task of writing an essay about “who I am” brings out significant dimensions, which are as follows: -

- Goal Setting
- Tendency to solve problem
- Locus of resources
- Source of initiation



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

LOCUS OF CONTROL - THE ENTREPRENEURIAL ORIENTATION INVENTORY*

Instructions: This Inventory contains twenty pairs of statements. In each pair, you may agree with one statement more than the other. You have five points to distribute between the two statements in each pair, to indicate the extent to which you agree with each of the statements. You may distribute the five points in any combination (0-5, 1-4, 2-3, 3-2, 4-1, 5-0). If you agree slightly more with statement "a" than with "b", then assign three points to "a" and two points to "b". If you agree completely with "a" but do not agree at all with "b", assign five points to "a" and zero to "b".

You may not divide your points equally (i.e., 2.5) between the two choices. You must choose one statement with which you agree more and then distribute the points.

| | Points |
|--|---------------|
| 1. a) How successful an entrepreneur will be depends on a number of factors. One's capabilities may have very little to do with one's success. | |
| b) A capable entrepreneur can always shape his or her own destiny. | |
| 2. a) Entrepreneurs are born, not made. | |
| b) It is possible for people to learn to become more enterprising even if they do not start out that way. | |
| 3. a) Whether or not a salesperson will be able to sell his or her product depends on how effective the competitors are. | |
| b) No matter how good the competitors are, an effective salesperson always will be able to sell his or her product. | |
| 4. a) Capable entrepreneurs believe in planning, their activities in advance. | |
| b) There is no need for advance planning, because no matter how enterprising one is, there always will be chance factors that influence success. | |

5. a) Whether or not a person can become a successful entrepreneur depends on social and economic conditions.
- b) Real entrepreneurs can always be successful, irrespective of social and economic conditions.
6. a) Entrepreneurs fail because of their own lack of ability and perceptiveness.
- b) Entrepreneurs are bound to fail at least half the time, because success or failure depends on a number of factors beyond their control.
7. a) Entrepreneurs are often victims of forces they can neither understand nor control.
- b) By taking an active part in economic, social and political affairs, entrepreneurs can control events that affect their businesses.
8. a) Whether or not you get a business loan depends on how fair the bank officer you deal with is.
- b) Whether or not you get a business loan depends on how good your project plan is.
9. a) When purchasing raw materials or any other goods, it is wise to collect as much information as possible from various sources and then to make a final choice
- b) There is no point in collecting a lot of information; in the long run, the more you pay, the better the product is
10. a) Whether or not you make profit in business depends on how lucky you are.
- b) Whether or not you make a profit in business depends on how capable you are as an entrepreneur.
11. a) Some types of people can never be successful as entrepreneurs.
- b) It is possible to develop entrepreneurial ability in different types of people.
12. a) Whether or not you will be a successful entrepreneur, depends on the social environment into which you were born.
- b) People can become successful entrepreneurs with effort and capability irrespective of the social strata from which they originated.

Entrepreneur and Entrepreneurship

- 13. a) These days, people must depend at every point on the help, support, or mercy of others (governmental agencies, bureaucracies, banks, etc.)
- b) It is possible to generate one's own income without depending too much on the bureaucracy. What is required is a knack in dealing with people.
- 14. a) The market situation today is very unpredictable. even perceptive entrepreneurs falter quite often.
- b) When an entrepreneurs' prediction of the market situation is wrong, that person can blame only himself or herself for failing to read the market correctly.
- 15. a) With effort, people can determine their own destinies.
- b) There is no point in spending time planning or doing things to change one's destiny. What is going to happen will happen.
- 16. a) There are many events beyond the control of entrepreneurs.
- b) Entrepreneurs are the creators of their own experiences.
- 17. a) No matter how hard a person works, he or she will achieve only what is destined.
- b) The rewards one achieves depend solely on the effort one makes.
- 18. a) Organizational effectiveness can be achieved by employing competent and effective people.
- b) No matter how competent the employees in a company are, if socio-economic conditions are not good, the organization will have problems.
- 19. a) Leaving things to chance and letting time take care of them helps a person to relax and enjoy life.
- b) Working for things always turns out better than leaving things to chance.
- 20. a) The work of competent people always will be recognized.
- b) No matter how competent one is, it is almost impossible to get ahead in life without contacts.

3.5 ACHIEVEMENT MOTIVATION

Motive

The basic question ‘What is Motive?’ has to be answered and understood before we discuss the various motives characterizing human behaviour and development. To put it in simple language, ‘motives’ can be defined as various psychological needs in varying degrees of strength which are reflected in the continuous concerns an individual has, and his thoughts as occupied with such concerns.

What is important for you as an entrepreneur is one motive and that is the motive for achievement. Achievement motivation can be described as ‘an urge in an individual to do something new, unique, an urge to excel in what he/she does and a long term involvement’. Before you move on you must understand that achievement motivation is necessary.

Though we are mainly concerned here with achievement motivation as related to entrepreneurship, we feel that you should know something about the sources of development of achievement motivation. They are:

Literature

As children, whatever we see, hear or read, influences us and our life. And when we grow up, our motivation depends on what we were exposed to in childhood. If we have been exposed to literature in any form which instills in us a desire to be independent, we exhibit a motivation to take our own decisions, to do something worthwhile in life, to have a goal, be an achiever. And this is further reinforced by what we read, see or hear, as well as our environment, as adults. To quote an example of a country, Japan, after its crushing defeat in the Second World War bounced back to become a rich and highly industrialized country. The reason was the literature which reflected the values of hard work and achievement in life.

Research in the field has shown that achievement motivation, as found in stories, newspapers and folk tales was reflected in the wealth or economy of a country and if and when it was not, the country started declining.

Child-Rearing

The way a child is brought up or reared, making him/her ‘achievement-oriented’, is also important, not only for the child but also for the community and country in general.

This early orientation, making a child independent in his/her thinking, involving him/her in decision-making at home and rearing him/her to take risks on his/her own, makes the child an achiever in life, thus influencing the country as a whole.

Here in our country we have street children who have to fend for themselves, which results in their becoming independent and develops in them the quality of decision-making.

As we have discussed in earlier units about the traits and qualities of an entrepreneur, achievement motivation is highly relevant to entrepreneurship. If you have achievement motivation of a certain degree, if you have a spark, it can be developed to make you a successful achiever, entrepreneur. But one

word of caution: having high achievement motivation alone may not be sufficient to make you a successful entrepreneur. There are certain other requirements too, which you will know about as you read on.

Achievement Motivation and Internality

The 'Internal Locus of Control' refers to the belief that whatever happens to you is to a large extent, caused by you and that you have control over the outcome of your actions. This does not mean that the external environment does not influence the outcome of your efforts. But you should believe that ultimately success or failure depends on how you are able to do certain things and the awareness that you can intervene to influence the outcome of external factors. In order to possess such an attitude, you should identify your strengths, concentrate on them and be confident of using the same to influence the outcome.

Developing Achievement Motivation

'Suppose I do not have achievement motivation, can I develop it?' Yes, you can. There is a specialized training programme called 'Achievement Motivation Training' which is based on experiential learning. The other alternative is introspection and an analysis of your strengths, weaknesses, opportunities and threats (SWOT). After going through the chapters on entrepreneurial traits and competencies, based on self-learning you can try to improve yourself in the areas where you find yourself weak, and convert the weaknesses to strengths. Achievement motivation can also be developed by thinking in the language of achievement. Your entire thought process (imagery) has to be achievement oriented.

3.6 ACHIEVEMENT PLANNING AND BUSINESS GOAL

One of the most crucial skills for an entrepreneur is to plan and implement action towards business goal. Why is this important? Let us examine.

Through planning, you will be able to clearly specify your goals, identify various activities, anticipate obstacles, enlist resources and also anticipate consequences. Often people having no patience for planning, jump to work and get stuck when faced with obstacles. Therefore, to be a successful entrepreneur, you need to develop skill and insight in planning and firm faith that planning is a must to ensure success in accomplishing goal.

Entrepreneurs always set challenging goals, which are realized with difficulty but bear unique fruits. They are often governed by achievement motivation, which has concern to attain certain standard of excellence. For this reason the planning practised by entrepreneurs are often called 'achievement planning'. This should not be mistaken for project planning. *Achievement planning provides for the necessary psychological preparation of the entrepreneur to pay adequate attention to those significant dimensions of his/her action areas, which contribute to his/her eventual effectiveness.*

Let us understand how planning can be effective from this case study.

CASE STUDY

Jhora Medhi (34) a shy, homely lady decided to enter the field of entrepreneurship. She belongs to a family where service is the main occupation. After completing her HSLC, she discontinued her study and got married. She always wanted to do something to be financially self-dependent. After her marriage she felt that she had to supplement her husband's income for the economic well being of her family. She could do this by starting some income generating activity in her home itself. She observed that varieties of fruits were available in her locality. But fruits get wasted most often during the harvesting season. She had a hobby of making jams, jelly, pickle etc. for use in her own home. She felt that she could convert her hobby into a profitable source of income generation. She discussed her idea with her husband. Her husband also liked the idea of doing something to generate additional income. She started to make jams, jelly, and pickle and sold them to her friends and relatives. The products were good. Her friends and relatives began to appreciate them. This encouraged her further to continue her effort to make jams, jelly etc. In the meantime IIE organized an EDP at Nagaon. She came to know about the programme and wanted to participate in it. She was admitted in the training. The training gave her further confidence to convert her income generating activity into an entrepreneurial activity. But to do so, she needed money, machines, manpower etc. She could approach bank for loan. But she was not certain if she could get a loan from bank. For machines she could not depend on the local market.

In addition, she also needed to know the formalities for starting a food processing unit. But money was the most important resource for her to start her enterprise. She thought it worthwhile to start her enterprise on her own without any finance from bank. She had about Rs. 20,000/- in her savings account. With this initial investment of Rs. 20,000/- she started a fruit processing unit at Nagaon. This small amount of money was inadequate to run her unit. She then approached her friends and relatives to get money for running her unit. The problem of finance and machine could be solved. Now there was the problem of marketing. It is now not an income generating activity for her. It was an entrepreneurial activity.

She had to be able to market her products not only in the local market but also the outside market. She employed two salesmen to sell her products. The salesmen used to travel from place to place to sell the products. They took the products to different places in the morning and returned in the evening. In this way she could get the market of central Assam. Jhorna also used to travel to different towns and villages at regular intervals to establish contact with the sellers to sell her product. This helped her a lot in popularizing her products. In addition, she also used to put up advertisements to create awareness of her food processing unit and the quality of her product. Now there are ten persons working in her unit. Initially she faced the problem of getting FPO licence. She had to take a lot of trouble to overcome the problem. Her annual turnover during 1999 – 2000 was about Rs. 2 lakh.

What is the secret of her success in her entrepreneurial activity? She stated that hard work, foresight and planning are the major contributing factors in the success of her enterprise. Establishing linkage with market and her strong determination to be a successful entrepreneur contributed to her success.

(Source: *Women Entrepreneurs in India, Published by NISIET, Hyderabad 2002*)

We have understood from the case how planning is important for setting up an enterprise. However, planning also requires systematic analysis and careful implementation. In other words, planning is also known as the “blue print for the entrepreneur. Let us look at the various steps of planning.

3.6.1 How to Plan

The planning has to have some strategies. In order to achieve the desired goal, it involves nine steps:

- Analysis of Situation
- Goal Setting
- Enlisting Activities
- Anticipation of Potential Obstacles
- Location of resources
- Generating alternatives
- Anticipation of consequences
- Action Planning, and
- Feedback.

We will try to understand each of these one by one

Analysis of situation: Entrepreneurs analyze situation to perceive the emerging change and the problems that people will be facing to adjust to such changes. Such problem areas offer you the entrepreneurial/business opportunities.

Goal setting: Look for new ideas, product or services that people need. Use creativity and be innovative in setting challenging goal. Efforts should be made to make the goal crystal clear.

Enlisting activities: Being action oriented you as an entrepreneur will enlist activities needed to move towards goal.

Anticipation of possible obstacles: Every action is resisted. Entrepreneurs anticipate such barriers, which may arise within entrepreneurs themselves or in the environment.

Location of resources/help: If barrier exists then there must be some source/help somewhere to overcome it. You need to locate them.

Generate alternatives: Using the resource new activities are generated as alternatives.

Anticipate consequences: Before actual operation an entrepreneur anticipates the consequence based on previous experience and information.

Action planning: Action planning is a device meant to help the entrepreneur to crystallize the short term and intermediate goals; and to visualize corresponding actions which, in his/her view, will ensure the movement towards the goals.

ASSIGNMENT-1

If you want to make a good plan of action, you should be able to answer questions such as:

- What action is to be taken?
- Why must it be done?
- Where will it take place?
- Who will do it?
- How will it be done? and
- How much control (kind and degree) should be exercised.

See if you can respond to all the questions at one attempt. find out which question is taking longer than others. Perhaps then you have to spend a little more time. Remember there are no right or wrong answers. What is more important is your clarity and focus. Try this after six months and you will see the difference in your response.

3.6.2 Feedback

Feedback is essential feature of achievement planning. An entrepreneur seeks feedback and uses it to effect change in the course of action to ensure accomplishment of goal.

3.6.3 Planning a Habit

Make it a habit to clearly set goal and plan its accomplishment by stating activities, possible obstacles, resources to overcome barriers and suggesting alternatives. This will ensure you success in your entire venture.

Check Your Progress Exercise 2



- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

Fill up the gap with appropriate words that you have learnt through these units.

Do match answers given at the end of the unit after you have completed.

1. Entrepreneurship is concerned with ----- and putting it into social use against pay off.
2. ----- is used by entrepreneur to make innovation available to users/people.
3. Entrepreneurship contributes directly to national economy by increasing --- ----- and -----.

4. Entrepreneurship brings about changes in people's orientation towards solving ----- Taking ----- enhancing concern for -----.
 5. Entrepreneurial opportunities are sensed by scanning the -----.
 6. For selecting an enterprise, entrepreneurs consider its suitability to three Es including Entrepreneur, E----- and E-----.
 7. Entrepreneur works for ----- and accordingly believes in ----- before action.
 8. Entrepreneurs perceive ----- faster than common persons.
 9. Through planning entrepreneurs assess ----- required, quantity of ----- to be produced, and ----- where products/services are to be sold and the total ----- that has to be made and finally the ----- that is expected.
 10. A business plan is the ----- ----- ready with entrepreneur before actually launching a project.
-

ASSIGNMENT-2

(Achievement Planning and Business Goal)

Do this exercise on your own:

Identify an important task that you are required to complete by a specific date in the future.

1. Think about the task(goal).
2. Clearly state the goal. (Why you want to this?)
3. List out the activities needed to accomplish your goal.
4. List the problems you may face or which may arise in the "environment."
5. Suggest possible sources of help (from friends/parents\teachers} to overcome obstacles.
6. What are your chances of success or failure (indicate in% }.
7. Suggest alternative plans of action.
8. Draw plan of action.



3.7 LET US SUM UP

Developing entrepreneurial skills in us is possible. It requires right mindset to develop a strategy. Understanding oneself, own goal in life and identifying strengths and weaknesses are very crucial.

The locus of control both internal and external are important. In any task when we put our efforts, it leads to performance and further leads to outcome. Thus

believing in one's own self-efficacy and ability is crucial. The recognition of external locus of control can help to develop the tendency to solve problems, taking help and openness to feedback for improvement.

However in order to achieve success we must plan for success. We must follow the steps in planning. Let us remember that in planning, anticipation and alternative plan of action is important.

3.8 KEY WORDS

| | | |
|-----------------------------|---|---|
| Locus of control | : | Factors responsible for any event or an outcome for any action. The responsibility may be external factor or internal factor. The internal factor may be under one's control and the external factor is not within one's control. |
| Self-efficacy | : | Utilising one's own full potential for performance. |
| Achievement planning | : | necessary psychological preparation of the entrepreneur to pay adequate attention to those significant dimensions of his/her action areas, which contribute to his/her eventual effectiveness. |
| Acquisition | : | A recently acquired asset or object, the act of acquiring. |
| Accomplishing | : | Achieving or completing successfully. |
| Accomplishment | : | Something that has been achieved successfully, an activity. That one can do well. |
| Anticipate | : | Be aware of and take action regarding something likely to come about in the future. |
| Blue Print | : | A design plan or other technical drawing. Something which acts as a plan, model |
| Conducive | : | Contributing or helping towards. |
| Crystallize | : | Form or cause to form crystals, make or become definite and clear. |
| Discrepancy | : | An illogical or lack of compatibility. |
| Discontentment | : | Lack of satisfaction. |
| Enhance | : | Increase |
| Loci | : | Particular point or place. |

- Perceive** : Become aware of or conscious of.
- Recognition** : Knowing again.
- Visualize** : Form a mental image.



3.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

(The Entrepreneurial Orientation Inventory Scoring Sheet)

Name ----- Date -----

Instructions: Transfer your point allocations from the inventory form onto this scoring sheet.

Internal Locus
of Control

External Locus
of Control

1 b -----

1 a -----

2 b -----

2 a -----

3 b -----

3 a -----

4 a -----

4 b -----

5 b -----

5 a -----

6 a -----

6 b -----

7 b -----

7 a -----

8 b -----

8 a -----

9 a -----

9 b -----

10 b -----

10 a -----

11 b -----

11 a -----

12 b -----

12 a -----

13 b -----

13 a -----

14 b -----

14 a -----

15 a -----

15 b -----

16 b -----

16 a -----

17 b -----

17 a -----

18 a -----

18 b -----

19 b -----

19 a -----

20 a -----

20 b -----

Total Internal -----

Total External -----

Determine the ratios of your internal/external locus of control scores by dividing the total internal score by the total external score. Record the amount here -----

Internal/external ratios above 3.0 indicate a high level of entrepreneurial internality; the chances are high that such individuals will initiate entrepreneurial activities. Ratios below 1.0 indicate that the respondent has a more external (less entrepreneurial) locus-of-control orientation. There is a need for this type of person to become more internal in order to be able to initiate and sustain entrepreneurial activities. Ratios above 1.0 indicate possible entrepreneurs. The higher the ratios above 1.0, the more internal the respondent is.

* Test developed by T.V. Rao. Reproduced from the 1985 Annual, "Developing Human Resources", Leonard D. Goodstein and J. William Pleiffer Edition. San Diego, California University Associates.

Check Your Progress Exercise 2

1. Innovation
2. Enterprise or Venture
3. GDP or GNP, and --- employment opportunity
4. Problems, -- Risk, --- Excellence
5. Environment
6. Enterprise, --- Environment (reverse also)
7. Success, --- Planning
8. Resources
9. Resources, -- Product, , --Places
investment, --- Profit
10. Blue print

3.10 SOME USEFUL BOOKS

1. Akhouri, Mishra and Sengupta. R. (1999) Trainers Manual on Developing Entrepreneurial Motivation Published by NIESBUD.

**Entrepreneur and
Entrepreneurship**

2. C.B.S.E. (2002) “Entrepreneurship Class XI & XII”.
3. Gupta, C.B. (1992) Entrepreneurial Development, Sultan Chand & Sons.
4. Raju, U.B. and Rani, C. (Ed.) (2002) Women Entrepreneurs in India, Published.
5. Raymond, W.Y. Kao Tan Wee Liang (2001) Entrepreneurship and Enterprise Development in Asia, Prentice Hall.

UNIT 4 BUSINESS IDEA – HOW TO GET IT?

Structure

- 4.0 Objectives
- 4.1 Introduction
- 4.2 What is Business?
- 4.3 Business Opportunity Identification and Assessment
- 4.4 Sources of Business Idea
- 4.5 Generation of Business Idea
- 4.6 Evaluation of Business Idea
- 4.7 Let Us Sum Up
- 4.8 Key Words
- 4.9 Answers to Check Your Progress Exercises
- 4.10 Some Useful Books
- 4.11 Assignments

4.0 OBJECTIVES

After studying this unit, you should be able to:

- make a distinction between economic and non-economic activities;
- understand the meaning and nature of business;
- identify various business opportunities, which a businessman may come across;
- describe the various sources from which a businessman may derive business ideas;
- understand as to how to generate the business ideas; and
- comprehend the evaluation procedure of a business idea.

4.1 INTRODUCTION

All of us are always engaged in some activity or the other. In the morning when we get up we brush our teeth, take bath, offer prayers and have our breakfast. Then, you as a student go to your Study Centre for studies. Your parents go about their own occupations. In the evening somebody may watch television or go for playing. The point, which needs to be stressed here is, that every human being is busy in some activity or the other.

A person may do a particular piece of work just to derive happiness or peace within himself. This is a non-economic activity. Another activity, may be to earn money. This is an economic activity. Business falls in the category of economic activity – the objective being to earn money.

A business can be started by any person. It can be pursued as a career by him. He may start a business with any amount of money. The range of investment may be as low as Rs. 100 or as high as Rs. 1,00,000 or even more depending upon how enterprising and courageous he is. But have you ever thought of the aspect which we all need the most to start a business? Well, it is the idea of –

What to Do?

A businessman needs to decide upon the type of activity, which he will be interested in pursuing. Let's change your role for a moment. Visualize the following:

You have just completed the present Diploma Course. You want to start your own business. The pertinent question here is – which business you want to be involved in. Whether you want to manufacture something or simply want to start a trading business. Are you in a dilemma? If the answer is yes, here is a hint for you.

Look around yourself and try to identify an opportunity. May be you get your answer by keenly observing the environment i.e. consumers, producers, products, competitors, government, society etc. Well, this is exactly what a businessman does.

The businessman starts the initial work of identifying various business opportunities, which he may come across. He then evaluates these opportunities and gives a shape to his business idea.

4.2 WHAT IS BUSINESS?

In this Unit we shall discuss about business, business opportunities, business ideas and other related aspects.

As already mentioned, business is an economic activity. The objective of doing any business is to earn profit. Business involves a wide range of activities like manufacturing, trading, transportation, warehousing etc.

Definitions of business

1. *According to B.O. Wheeler:* “Business is an institution organized and operated to provide goods and services to society under the incentive of private gain.”
2. *As per Section 2 (13) of the Income Tax Act, 1961:* “Business is any trade, commerce or manufacture or any venture in the nature of trade, commerce or manufacture.”

Features of business

Let's discuss the features of business one by one

1. *Economic activity*

Business is an economic activity because it involves production, exchange and distribution of goods and services for profit, e.g. Arun sells goods worth Rs. 1,000 to Bhanu for Rs. 1,200 – it is a case of business activity. In case Arun donates Rs. 11 to a temple it is not a business activity.

2. *Profit motive*

The main aim of a businessman is to earn profit. If a businessman is manufacturing cloth or is dealing in purchase or sale of wheat – the main reason behind this activity is some kind of gain or reward.

3. *Goods or services*

A businessman deals in goods or provides services.

The *goods* in which he may deal are of two types:

- (i) Consumer Goods;
- (ii) Producer Goods

Consumer goods are those goods, which are used by consumers to satisfy their needs and wants directly. In this case goods are used or consumed after their purchase. The examples are – bread, milk, cloth, pulses, furniture etc.

Producer goods, also known as capital goods, are those goods, which help in the manufacture of consumer goods. These goods are used by manufacturers and not consumers. Examples are – tools and equipment, machinery boilers, wheat used as seeds for further growing, etc.

The *services* in which a businessman may deal in, can be grouped as below:

- Transport
- Warehousing
- Advertising
- Marketing
- Banking
- Insurance

4. *Production of goods and services*

A businessman endows utility to a material by making it more useful and suitable. A businessman can satisfy human wants only if he makes something useful e.g. cotton as such is of no use to consumers. But if the same cotton is converted into cloth by a manufacturer, the needs and wants of the customers are satisfied. This way, the businessman by manufacturing, processing or altering the material creates ‘form utility’ to make the product more useful.

5. *Distribution of goods and services*

Have you ever thought of how wheat cultivated by the farmer reaches the final consumer i.e. you and your family and others in society? Well, it is due to the distribution function of trade. Distribution of goods and services is a function, which facilitates the flow of goods and services from the manufacturer to the ultimate consumer.

6. *Risk*

Every kind of business involves risk – whether small or big, whether manufacturing or selling, whether done in rural areas or urban areas.

A business involves risk due to uncertain factors. The businessman does not have full control over his environment e.g.:

- The tastes and fashions may change;
- Level of competition may rise;
- Government policies, commercial, fiscal etc. may change in the country;
- Technology of production may change;

There is a direct relationship between the risk and profit. Higher the risk, higher the profit. In a way, profit is the reward for risk-bearing. Profit is termed as the compensation for risk undertaken by the businessman.

7. *Sale, transfer and exchange*

Buying, selling and exchange of goods and services are the essential features of any business. Sale and exchange for a price is a must if the activity is to be considered as a business activity.

Forms of business activities

Business activities, *inter-alia*, may take the following forms:

- Agricultural activities – growing of crops, preparing harvest for the market, preservation etc.
- Manufacturing activities – manufacture of pickles, jams, papads, biscuits, chutneys, spices, sauces, pump sets, agricultural implements, spare parts etc.
- Trading activities – buying and selling in wholesale, retail or barter
- Service activities – transportation, warehousing, insurance etc.
- Reproducing and multiplying activities – nurseries which multiply and sell plants, plant materials
- Mining activities – exploration, extraction of minerals, iron ores, gold, diamonds etc.
- Constructing activities – construction of buildings, warehouses, cold storages, silos, etc.

4.3 BUSINESS OPPORTUNITY – IDENTIFICATION AND ASSESSMENT

Business opportunity identification

Let's begin with identifying various business opportunities.

As we are all aware one should know how to swim before plunging into the water or else the person will get drowned. Same is the case with a person who wishes to start a business of his own he should acquire necessary knowledge. Even when he thinks of expanding his existing business, he has to update his knowledge.

The process begins with an effort to think out an attractive set of opportunities for the firm. In case the firm has too many opportunities, the task will be to select from among them.

A businessman can choose an opportunity from his environment. As long as there are unsatisfied needs and wants, there will be opportunities. Identification of such opportunities requires imagination, sensitivity and realistic assessment of what a businessman can do. For example, in the modern world the need to develop new sources of energy, to improve agricultural methods etc.

By going through the following examples, you'll understand more will throw up many possibilities clearly how a businessman can identify business opportunities.

Example I

Nanak discovers that there is no wholesaler dealing in sugar in his area. Nanak sees an opportunity in becoming wholesaler himself.

Example II

Rakesh, a student living in Shahibabad, is undergoing a Diploma Course on Value Added Products from Fruits and Vegetables conducted by IGNOU. One of his cousins Amar works as a gardener in AIIMS in New Delhi. Casually Amar discloses to Rakesh that affluent families in Delhi living in big bungalows maintain a kitchen garden in their courtyards but they find difficulty in obtaining seeds of good quality of various fruits and vegetables, green/flowering plants and high quality manure. Here, Rakesh is face-to-face with a business opportunity of selling good quality seeds (even imported ones), green/flowering plants and manure in Delhi and nearby areas. He can also act as Garden and Landscape consultant.

Example III

A commercial bank announces a loan scheme under which loan can be obtained for business purposes at a reasonably low rate of interest. The loan can be repaid in easy installments. Ravi, a money-starved young businessman who owns a juice shop reads about the loan scheme on a visit to a branch of that bank. He has identified an opportunity for expanding his juice shop.

Activity

Scan your environment thoroughly. Think. And then identify five business opportunities and list them in a serial order in the space provided below:

| Sl. No. | Business opportunity identification |
|----------------|--|
| 1. | |
| 2. | |
| 3. | |
| 4. | |
| 5. | |

Opportunity assessment

After the businessman has identified various opportunities, the next step is to evaluate these opportunities. The opportunities need to be assessed before the best one is transformed into a business idea.

Let's now study the procedure of assessing an opportunity, which has been identified.

i) *To choose the relevant opportunities*

The businessman has to make a choice of the relevant opportunities out of the various opportunities available in the environment. Certain opportunities (and not all) will be relevant only if they meet the purpose, objectives and growth strategies of the firm.

For example, Darshan Kumar, a manufacturer of vegetable sauce, finds that the Finance Minister has announced slashing of excise duty on steel. This is an opportunity, which a businessman may find to be quite useful but it has no relevance to Darshan Kumar because he is in the business of manufacturing vegetable sauce using various vegetables and not steel.

In other words, business opportunities should be consistent with the purpose and objectives of the firm.

ii) *To evaluate the sales potential of each opportunity*

After identifying the available relevant opportunity, the businessman should evaluate the sales potential of each opportunity. In this context, following questions need to be considered:

- a) Who would buy the product;
- b) How much the potential customers can pay;
- c) How many customers would buy the product;
- d) Which strata of society would buy the product;
- e) Who will be the competitors;
- f) How would the product be distributed.

iii) *To evaluate the financial aspect of each opportunity*

Each identified opportunity is required to be evaluated in terms of financial aspects. This will lead to proper and detailed estimation of cost. The various items on which long-term funds can be committed are:

- a) Cost of land and site development
- b) Cost of building
- c) Cost of plant and machinery
- d) Money required for working capital

iv) *To evaluate the technical aspect of each opportunity*

Evaluation of each identified opportunity in terms of technical aspects is also an essential step. The various technical elements to be evaluated are:

- a) Type of raw material to be used – agricultural product or livestock product or mineral product;
- b) Manufacturing process;
- c) Plant capacity required;
- d) Technology for manufacturing – whether to purchase or make it available through *joint venture* arrangement.
- e) Availability of infrastructure – power, transportation, water and communication.

v) *To evaluate the marketing aspect of each opportunity*

Each business opportunity should also be analyzed from the point of view of how to enter the market. The company should make an effort to know what its competitors are offering to the consumers and in which way can the consumers be satisfied.

The businessman should bank upon that opportunity which is most feasible and promising.

Check Your Progress Exercise 1



Note: a) Use the space below for your answer.

b) Compare your answers with those given at the end of the unit.

1. Read the following paragraph, identify the relevant business opportunity and fill your answer in the space provided.

Manoj is a young enterprising man. He owns a sweet shop. He is well versed with Indian culture and festivals. He knows that on the occasion of various festivals people make different kind of sweets and namkeens. Here, he finds a good business opportunity to be turned into a viable business idea. He may

.....

2. You are Kailash Nath and you own a *chakki* shop. Through your customers, you come to know that packed masalas (i.e. packed spices) available in the market are not of good quality as they are thought to be adulterated. In the following space write down the relevant business opportunity, which you will identify.

.....

.....

.....

.....

4.4 SOURCES OF BUSINESS IDEA

Once an opportunity has been identified and assessed, the next step for a businessman is to translate the business opportunity into a viable business idea. In this respect the businessman has to seek the sources from where he can get his business idea so that the available opportunity is translated into a profitable venture.

A businessman should keep his mind open. According to Promod Batra, a management expert “A closed mind is like a gloomy cave made gloomier by the cobwebs of ignorance and prejudice, whereas an open mind is like a green meadow where fresh ideas spread and blossom. The businessman should therefore, step out of the morass of stagnant thoughts into the open field of bold new opportunities. He should soar high on the strength of an exploring mind to reach unknown heights of achievement and success.”

The various *sources* from where a businessman can derive business ideas are presented in Figure 4.1.

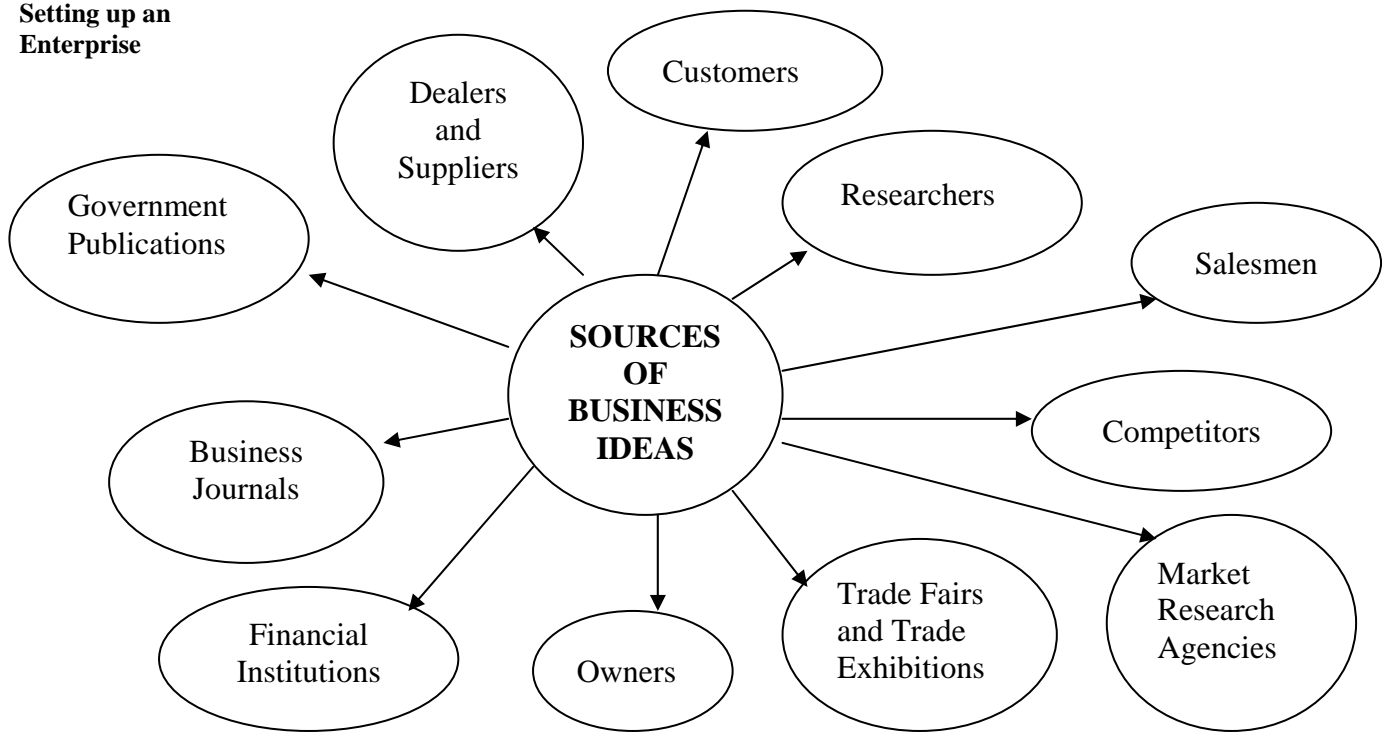


Figure 4.1: Diagrammatic presentation of sources of business idea

These are detailed in the following paragraphs.

1. *Customers*

Customers, whether Indians or foreigners, are the primary source of business idea. Customers, as we know, are the pivot around whom the entire marketing process revolves. Customers are those persons who use or consume the product and therefore, are the best judge. The ideas or the criticism provided by these esteemed customers are valued greatly by the business firms. The business unit can identify customers' needs and wants through surveys, group discussions, suggestion system etc.

2. *Researchers*

Researchers are those talented scientists, who because of their various scientific research programmes conducted in the labs, try to bring out something new – it can be a new product or modification of an existing product or a new form of packaging material. Big companies maintain R & D department for this purpose only. R & D labs carry out research and hence become a source of business idea.

3. *Competitors*

A businessman should never undermine his competitors. He should monitor the activities and strategies used by them carefully specially in connection with bringing out new products, new methods of selling, and new promotional measures. A businessman should try to add some value to their product and build a far better product than his rivals.

4. *Salesmen*

Salesmen or sales-managers or sales representatives – with whatever name we may call them – are the ones who come in direct contact with the final consumers. Whether it is a multi-national company (MNC) of Nestle or

Kellogg fame or a local chat-papri shop – the customers interact only with the salesmen while buying the product. In this process, the sales persons happen to get exposed to complaints and problems faced by the customers while using the product. They also come in contact with the unsatisfied needs of the customers as well. They can lead the owners of the business firms on to the right track. Therefore, they are a good source of business ideas.

5. *Owners*

The owner of an enterprise can be a single person or a group of persons depending upon the form of business ownership. They are also a major source of business ideas. They may have a creative and innovative mind churning out new ideas to take their enterprise to the top.

6. *Government publications*

Government Publications are also an important source of business ideas. Data, provided in various Government publications, act as a harbinger for business improvement. The scope of further investment can also be estimated. The various publications like Economic Surveys published by the Ministry of Finance, Guidelines to Industries published by the Department of Industries, Annual Reports of the various Ministries etc. provide information about structure, location, licensed and installed capacity etc. of various projects. Through analysing the available statistics regarding exports and imports a trend of foreign trade can be judged. Idea about import substitution can be generated by analysing the data of imports and possibility of exports can be estimated through export data.

7. *Business journals and financial newspapers*

Information regarding business idea can also be gathered from business journals, business bulletins, business magazines, financial newspapers etc. Some of these are:

- Indian Textile Bulletin
- Indian Packaging Directory
- Glass Udyog
- Glass Gazette
- Business India
- Business World
- Economic Times
- Financial Express
- RBI Bulletin

8. *Financial institutions*

Commercial banks, RRBs, State Co-operative Banks, State Financial Corporations, EXIM Bank, IDBI, SIDBI etc. are there to promote development of Industries, to conduct studies and to offer valuable suggestions to potential entrepreneurs.

9. *Market research agencies*

Market Research Agencies (MRAs) are also an important source of business ideas. These agencies conduct marketing research covering

different segments of the market. They prepare research reports for their clients. Some of the MRAs are Indian Market Research Bureau (IMRB), Marketing and Research Group (MARG), Operations Research Group (ORG), National Council of Applied Economic Research (NCAER), Marketing Operations, Design and Enquiry Service (MODE), and Pathfinders India.

10. Trade fairs and trade exhibitions

Trade Fairs and Trade Exhibitions also contribute in searching for a business idea. Direct interaction takes place among the manufacturers, dealers, suppliers and customers through these fairs and exhibitions. National and International trade fairs provide an excellent opportunity to know about new products and development of existing products. A lot of information/data can be collected which may be used for evaluation purposes.

11. Dealers and suppliers

Business ideas given by Dealers and Suppliers are also an important source. Therefore, their viewpoint should also be considered because they have first hand exposure to customers' unsatisfied needs and complaints.

12. Performance of existing industries

The profitability and return on investments of various industries (region wise) are also one of the important sources for gathering business ideas. The potential for investments in the particular industry (e.g. fruits and vegetable processing industry) can thereby be analysed and judged.

Activity

In the following Table you will find unsatisfied needs and other problems of the customers as well as the relevant product to mitigate the problems. Scan the environment and fill in the Brand Name of the Product:

| <i>Customers' unsatisfied needs and problems</i> | <i>Relevant product</i> | <i>Brand name of the product</i> |
|--|-------------------------|----------------------------------|
| 1. Heart Problem | Edible Oil | |
| 2. Diabetes | Sugar Free Tablets | |
| 3. Travelling | Sauce in sachets | |
| 4. Hygiene | Water | |

(Hint: 1. Saffola Gold, 2. Equal, 3. Kissan and 4. Bisleri)



Check Your Progress Exercise 2

Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Name two financial newspapers from which the businessman may get a business idea.
 - i)
 - ii)

2. Customers are an important source of business idea because:

.....
.....
.....

4.5 GENERATION OF BUSINESS IDEA

Identification of business opportunity and its assessment leads the businessman to generate business ideas, which can translate the opportunity into a profitable venture.

Business idea can never come from a vacuum. Instead it originates from a creative and enthusiastic mind feeding on an active environment.

The process of identifying business idea should always be done in a systematic and rational way. It is always better “To think at leisure and never repent” and not “To act in haste and repent at leisure.” That is why, the businessman should sensibly scan the environment, which consists of himself, his prospective customers who will buy from him, his prospective suppliers, his prospective competitors whom he has to face, etc.

The businessman can generate a business idea to sense a business opportunity in different ways. But before detailing them out let’s go through some of the examples given below. These examples contain the opportunity and its transformation into a business idea.

Example 1

| Business opportunity | Business idea generated |
|---------------------------------------|---|
| A cold storage is built in a village. | The businessman gets an idea to deal in off-season fruits and vegetables as well. |

Example 2

| Business opportunity | Business idea generated |
|--|--|
| Indian Railways starts a new train on a new route. | The businessman (dealing in flowers i.e. florist) gets an idea to expand his business by delivering the flowers through the new train to other areas, which were hitherto not tried. |

Example 3

| Business opportunity | Business idea generated |
|--|---|
| State Government announces the plan to provide free mid-day meals in primary schools in a village. | The businessman puts in efforts to take the contract of supplying vegetables to the contractor. |

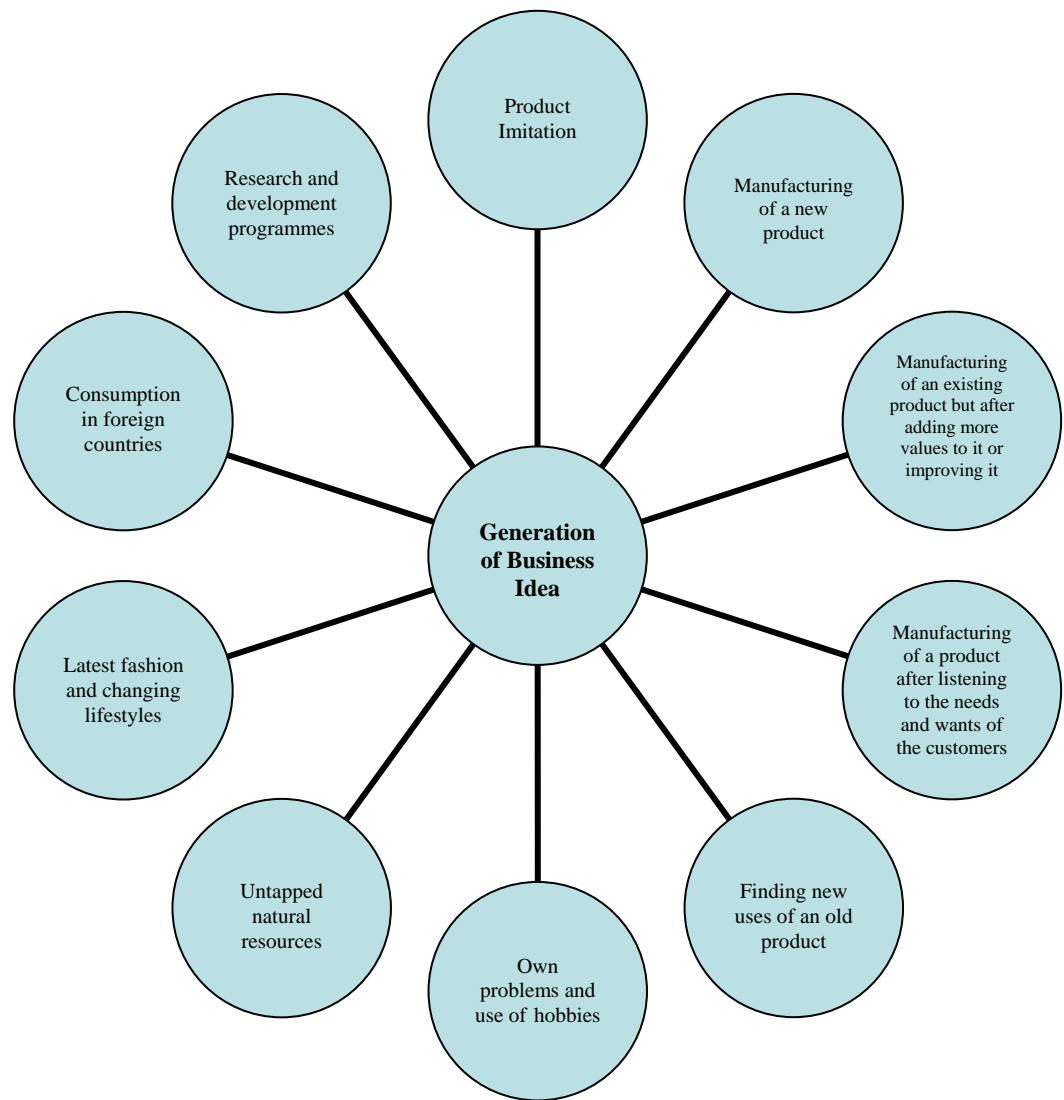


Figure 4.2: Diagrammatic presentation of generation of business idea

Now, let's discuss the generation of business idea.

- 1. Product imitation:** The businessman can think of manufacturing any product, which already exists in the market. In other words the businessman may think of making a product, which already has a market. He wants to bank upon the efforts put in by his rivals. Product awareness and product acceptability are already there. Acquisition of an existing product obviates the costly and time-consuming process of building resources and reputation. For example, Suresh plans to manufacture instant Gulab Jamun mix. Here, Suresh is saved from putting in extra efforts and money to launch a totally new product as the customers are aware of this product and have accepted this mixture through which instant Gulab Jamun can be made.
- 2. Manufacturing of a new product (Product innovation):** A businessman can plan to make a non-existing product, which is not available in the market. Well isn't it a big deal? Every businessman cannot do such an act. One needs to be extra bold, courageous, risk taker and adventurous, for it can be a risky proposition. Can you think of a new product, which has been recently launched in Indian food markets? Yes, there are products like Tomato Puree, Ginger-Garlic paste, instant cake mix etc. But there are

certain other new products also (though not linked with food industry) like mobile phones with camera, solar cookers, Jackets with in-built fans, etc. which were previously unheard of. Now-a-days some new types of namkeens like roasted wheat, roasted Kabuli (white) Chana, roasted moong dal etc. (cooked without using oil) have emerged in the market.

3. *Manufacturing of an existing product but after adding more value to it or improving it:* At times, a businessman thinks of manufacturing an existing product but with a difference. He tries to make that product slightly different from the product of his rivals by making some changes in the product. For example, 'Marie' biscuits are now in the market as 'Marie Gold' biscuits enriched with wheat fibre and with a slogan "better tastier and healthier". Some of the other examples are given below:

- Pickles are sold with a new and better package;
- Custard powder is now sold with some added ingredients;
- Double Folding Umbrellas are an improvement over the single folded umbrellas in as much as they can easily be accommodated in ladies' purses;
- Sauces, herbal shampoos are sold in sachets.

4. *Manufacturing of a product after listening to the needs and wants of the customers:* With liberalisation and globalisation processes, the entire environment is changing. The life and life style of people are changing. People, by and large, are buried neck deep in their responsibilities and duties, entrusted to them by their bosses so that they hardly get time for themselves and for their family. More and more women are working and they have less and less time for their family. In this changing life style, they want products tailor-made to suit their requirements. The businessman can therefore, find more ideas by asking customers to describe their problems with the current product. He can also identify customers' needs and wants through customer surveys, group discussion, suggestion system and letters received from them. The products, which have taken birth after listening to customers' woes, are:

- Ready to eat food;
- Ready to eat mushroom soup, tomato soup etc.;
- Cake mix;
- Sprouted Dals;
- Roasted Namkeens;
- Pudding Syrups.

5. *Finding new uses for an old product*

At times, the businessman may find some more and new uses of the product to increase his turnover. For example, 'Ready to Mix' product – a mixture of Badam-Pista flavour; of chocolate flavour; and of strawberry flavour, was launched for making milk shakes of different flavours. But, later on a number of uses were added the product could be used in ice creams, puddings, cakes etc.

6. ***Own problems and use of hobby:*** Sometimes, a person may face a particular problem in real life like preparing lunch for taking to office. He may, after leaving the job, start the business of supplying packed lunch during lunch-time at various offices. Recently, a fat lady was totally upset as she was not getting ready-made clothes of her size. She thought of this problem and started making over-sized clothes meant for fat people.

A hobby can also be converted into a full-fledged business with proper planning and care. For example, a hobby of collecting flowers can be converted into making designer bouquets. Similarly, a hobby of making pickles and chutney can be converted into a Pickle and Jam business.

7. ***Untapped natural resources:*** Nature is very kind to mankind. It has given us plenty of resources like air, water, minerals, vegetation etc. Human beings satisfy their needs and wants through these natural resources. Here comes the role of a businessman. He can tap these natural resources and thereby satisfy the needs of the customers. For example, some of the products made through tapping solar energy are solar cookers, solar heaters etc.

8. ***Latest fashion and changing life styles:*** Latest fashions and designs and changing life-styles also contribute to the generation of business ideas. Nothing is permanent except change. Due to globalisation and liberalisation the common man especially the youngsters are a more aware and informed lot. The life-style of persons has also changed. An idea can be generated by observing keenly the latest fashions in the city. The businessman can therefore, make that product which goes well with the current market trend.

Earlier pizza was not thought of as a common item to be consumed by all sorts of people. Similarly 'pasta' and other popular fast food items like 'momos', 'macaroni' etc. were also not in common use. But now-a-days, due to changing life styles, all these items are liked by the common man and their consumption is quite frequent.

9. ***Research and development programmes:*** Many business units hope to find new ideas through their scientific research programmes.

10. ***Consumption in foreign countries:*** Observing consumption in foreign countries may also lead to generation of new ideas. Each country has its own culture, and different food habits. In India we like spicy and fried foods while in western countries boiled, baked and non-vegetarian food is preferred. These consumption habits of people living in different countries may be used by the businessmen to generate an idea, which may suit the needs and wants of the people living in our country.

Activity

Let's do some fieldwork. Visit five houses in your neighbourhood. Ask the occupants, (women and children preferred) about any kind of improvement they would like to see in a particular product (fruit and vegetable products preferred) and fill the boxes given below:

| Sl. No. | Name of the occupant | Age | Name of the product | Required improvement |
|---------|----------------------|-----|---------------------|----------------------|
| 1. | | | | |
| 2. | | | | |
| 3. | | | | |
| 4. | | | | |
| 5. | | | | |

Check Your Progress Exercise 3



Note: a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. State True or False;
 - i) Acquisition of an existing product obviates the costly and time-consuming process of building resources and reputation.
 - ii) A businessman should never plan to make something new, as it will always result in losses.
 - iii) The customers want customized products due to changing life-style.
 - iv) The company can identify the needs and wants of the customers through surveys and discussions.
 - v) Less business ideas are generated due to liberalisation and globalisation.
2. You are the manufacturer of “Delicious Biscuits (salted)”. Think and write in the space provided below any two new uses of the product.
 - i)
 - ii)

4.6 EVALUATION OF BUSINESS IDEA

Consequent upon the generation of business idea, begins the important task of its evaluation. Before the businessman gives a green signal to his project, he has to do some spadework. He should critically analyse his business proposal in question. This becomes imperative, keeping in mind the money involved – may be his life time savings - the physical and human resources used by him, utilisation of natural resources which may involve environmental degradation etc.

A businessman would always wish to turn his dream project into a reality and not a nightmare. Let’s now discuss the series of steps essential for any businessman to evaluate a business idea. These steps are as below:

1. Evaluate one-self

The businessman should have certain personal qualities. These qualities will help him to survive in the market, face the competition, to diversify etc. The qualities, which are very essential for any businessman, are as follows:

- Good health
- Sound mind
- Bold and confident spirit
- Knowledge of skill to be used in business
- Good interpersonal relations
- Dynamic attitude
- Innovative mind
- Cautious nature etc.

2. Collection of information

The next important step is to collect information about the environment in which the businessman plans to operate. The businessman may gather information directly. He may conduct surveys of the market and try to feel the pulse of the market and business methods of his rivals. He would assess the current tastes and fashions prevalent in society-motive for buying total demand, unsatisfied needs etc. Information can be collected through some other sources also like telephone directories, offices of Registrars of small-scale units, Census of India, RBI Bulletins, Journal of Indian Banks' Association, Economic Surveys etc.

Market Surveys conducted by the businessman are a costly affair, whereas information collected from other sources may not be fully reliable, accurate, or comprehensive. Therefore, it must be carefully examined.

3. Reviewing the limitations

Though an entrepreneur is bold in taking risks and facing challenges, he wants to make doubly sure and safe before he ventures into a new project. Therefore, he analyses those activities, which may act as hurdles at a later stage. His apprehension can be related to:

- Availability of required amount of capital;
- Availability of required land;
- Availability of required skilled and unskilled workers
- Strategies of the competitors etc.

4. Detailed investigations

“Think before you leap” is what the wise men say. A wise businessman is one who puts each new step cautiously. Before finalizing his business proposal, he should investigate about the following points, which if left unattended may prove fatal to his business:

- Investigation No. 1 (Capital Requirement)

The businessman should assess his capital needs. He should analyse whether the capital requirements are within the manageable limits or not. He can obtain funds from the following sources:

- i) His own savings;
- ii) Friends and relatives;
- iii) Commercial banks;
- iv) Regional Rural Banks;
- v) Co-operative Banks;
- vi) Agricultural Co-operative Societies etc.

A businessman may require money as fixed capital and as working capital. Fixed capital is required to purchase fixed assets like building, plant, machinery etc. and working capital is required to finance day-to-day operations.

Activity

Baldeo plans to open a local bakery shop and make ‘biscuits and other bakery items’. List the various items of expenditure for which he will be committing his capital as fixed capital and working capital:

| Fixed capital required for | Working capital required for |
|----------------------------|------------------------------|
| 1. | |
| 2. | |
| 3. | |
| 4. | |

(Hint: Fixed Capital required for – Small Building/Shed, Grinder, Vehicle, Furnace, Utensils. Working Capital required for – Expenses incurred for purchasing Raw Material like maida, sugar etc., Salary and wages to workers, Repair expenses of grinder, Monthly Rent to Landlord.)

- Investigation No. 2 (Location)

Location refers to a fairly broad area. It can be a village, a local area, a city, an industrial zone or a coastal area. Site is a specific piece of land where the project will be set up. A manufacturer will decide about the location of site of his factory and a trader of his shop. The cost of production and saleability as well as profitability of the concern depend much on its location.

A factory located far away from the place of availability of raw material or far away from the port town (in case of exports) will result in increasing the cost of production.

The choice of location depends upon certain other aspects also like availability of infrastructure (e.g. power, transportation, water, communication system etc.), government policies, pollution control, climatic conditions etc.

- Investigation No. 3 (Sources of Raw Material)

As per the needs of his business, the businessman shall require various raw material like cotton, jute, oil seeds, pulses, whole spices etc. The place from where raw material is to be obtained should also to be investigated. It is quite possible that prices of the required raw material may be different at different places. It may also happen that a particular dealer may offer some discount etc. Raw material can also be purchased from the wholesaler or directly from the producer. Transportation charges or delivery charges are also to be kept in view before finalizing the decision on the source of raw material. Quality of raw material is also to be considered. In addition, the question whether the dealer will be able to provide a regular supply of raw material – even when there is a shortage – should also be given full consideration.

Raw material can also be imported from the country of its origin. In this respect cost of freight levy import duty and the time lag involved should be given due consideration.

- Investigation No. 4 (Sources of Labour)

The businessman before starting his business needs to decide upon the place from where he would take his workforce. Recruitment of labour will depend upon the type of work, the businessman wants to start. He may require technical, skilled, semi-skilled, unskilled or highly educated workers depending upon the nature of work to be undertaken by him.

He should enquire about the places from where he would get the right kind of labour. He should also look into the past trend in labour rates, prevailing labour rates, labour attitudes and practices etc.

- Investigation No. 5 (Availability of Technology)

Choice of technology is an important factor for manufacturing a product. Choice of technology is influenced by many considerations like capacity of the plant, investment outlay, production cost, principal inputs, ease of absorption etc. In a nutshell, the technology should be such as has been proven to be successful by other manufacturers.

- Investigation No. 6 (Availability of Machinery)

The requirement of machinery will depend upon the plant technology and plant capacity. The businessman will enquire from various manufacturers and dealers about the price, quality and other terms and conditions (e.g. warranty period, after sales service etc.) regarding the machinery to be purchased. He can also think of importing a particular machine, if required. The businessman will work out through cost-benefit analysis and decide accordingly. If he plans to buy machinery from a foreign party, then he should work out a detailed analysis of the proposal because the cost may escalate due to import duty, transportation, insurance etc. and the exporter may be unknown to him. The machinery purchased should be of desired quality and capacity and should be purchased from a reputed supplier.

- Investigation No. 7 (Availability of Adequate Power Supply)

Supply situation of power, coal etc. needs to be thought of. The businessman needs to analyse whether power supply for his business proposal can reasonably be obtained from external sources? Whether he needs to install generator set. If yes, of how much capacity, etc. also the cost of the power.

5. *Consistency with government priorities*

The idea must be feasible from the point of view of national goals and government regulatory framework. The entrepreneur should ask himself whether there would be any environmental effect contrary to government regulations, He should also visualise the foreign exchange requirement, if any.

6. *Cost reasonableness*

The businessman has to take into account the cost of the project in hand. The cost structure should be such that it enables him to realize an acceptable profit with a competitive price. He should examine cost of material, labour cost, general administration cost, service cost, selling cost etc.

7. *Adequacy of the market*

The businessman should analyse that the size of the present market must offer the prospects of adequate sales volume and a reasonable return on investment. Moreover, there should be potential for growth. He should analyse the total present domestic market, competitors and their market share, sales and distribution system, barriers to the entry of new units etc.

8. *Assessment of risks*

The desirability of a project is critically dependent on the risk inherent in it. The businessman should analyse the threat from competitors, vulnerability to business cycles, competition from importers etc.

9. *Scale of operation*

To decide the scale on which the business is to function is an important aspect that needs to be emphasized. The businessman can operate on small, medium or large scale depending upon his finances, abilities and entrepreneurship as also size of the market etc.

10. *Form of business ownership*

The form of business ownership is yet another dimension which is to be thought upon before commencing the business. The important forms of business ownership are sole proprietorship, partnership, company (private or public), co-operative society etc.

11. *Compliance with legal formalities*

The businessman should also evaluate the business in terms of legal formalities, which need to be fulfilled. A variety of licences, approvals, clearances etc. may be required to be obtained from the authorities depending upon the nature of business. Some of the examples are given in the following Table:

| Nature of the business | Relevant authority |
|------------------------|--|
| Packed Foods | Directorate of Marketing & Inspection, Ministry of Agriculture |
| Excisable Products | Central Excise Department |
| Bakery Items | Local Authority/Health Department |
| Confectionery Shop | Local Authority |

Conclusion

After going through critically and analytically the various investigations and other relevant points related to the evaluation of a business idea, it is then time for the businessman to select the best idea. Now, a question arises as to which is the best project.

In this respect, it may be noted that the project which will give the maximum profit with least input should be given a green signal. In other words, the optimum business idea should be selected.



Check Your Progress Exercise 4

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Mr. Khanna always insures his goods while transporting them from his godown to his shop. Name two qualities reflected by Mr. Khanna.

- i)
 ii)

2. Match the following:

| Nature of the business | Ideal location of the business |
|---|--|
| 1) A project meant for manufacturing a perishable product | a) To be located near to the centres from where raw material is easily available |
| 2) Factory | b) To be located near to the port |
| 3) A project based on imported raw material | c) To be located near to the centres of consumption |



4.7 LET US SUM UP

Every human being is busy in some activity or the other, categorised as economic activity or non-economic activity. Business is an economic activity, prime motive being to earn profit. The businessman earns profit by satisfying the needs and wants of the customers through marketing. The process of marketing begins with an effort to develop an attractive set of opportunities for the firm. A businessman can choose opportunity from his environment. After

the identification of various opportunities, the businessman may evaluate these opportunities in the light of sales potential; financial, technical and marketing aspects. Further the businessman should take steps to translate the identified business opportunity into a viable business idea. The various *sources* from where a businessman can derive business ideas are customers; researchers; competitors; salesmen; business journals; financial institutions; market research agencies etc. Identification of business opportunity and its assessment thereof leads the businessman to generate business ideas, which can translate the opportunity into a profitable venture. The businessman should, thereafter, evaluate the various aspects of business idea. He should, thereafter, choose a project, which will give him the maximum profit with minimum of input resources.

4.8 KEY WORDS

| | |
|------------------------------|--|
| Business environment: | It is a total of all external factors, which affect the organisation and operations of business. Consumers, suppliers, competitors, government etc. constitute the business environment. |
| Business risk | : A Possibility of loss due to some unforeseeable, unpredictable or unfavourable events which may occur in future. |
| Fixed capital | : Amount of money invested in purchasing non-recurrent assets, which will give benefits to the business for a relatively longer period of time. |
| Location | : A fairly broad area like a city, industrial zone or a coastal area. |
| Trade | : Buying and selling of goods and services. |

4.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES



Check Your Progress Exercise 1

1. Prepare such festival sweets and sell them.
2. He thinks of grinding the whole spices in his own *chakki*. Kailash Nath thus identifies a business opportunity.

Check Your Progress Exercise 2

1. i) Economic Times
ii) Financial Express
2. They are the ones who are the end users of the product. Consequently, they are in a position to tell the problems faced in using the product. Their unsatisfied needs and wants may lead to development of a new product or improvement / value addition in the existing product.

Check Your Progress Exercise 3

1. i) T ii) F iii) T iv) T v) F

2. i) Add topping of onion and tomato and spices etc. along with cheese.
- ii) Break and crumble the biscuits. Add Bikaneri Bhujjia, onion and other spices. And mix a few drops of lemon.

Check Your Progress Exercise 4

1. i) Cautious
ii) Good Planner
2. 1) c 2) a 3) b

4.10 SOME USEFUL BOOKS

1. Bhushan, Y.K. (2005) Fundamentals of Business Organisation and Management. Sultan Chand and Sons, New Delhi.
2. Chandra, Prasanna (1996) Projects, Planning, Analysis, Selection, Implementation and Review, Tata McGraw-Hill Publishing Company Limited, New Delhi.
3. Kotler, Philip (2004) Marketing Management – Analysis, Planning and Control, Prentice Hall of India, New Delhi.

4.11 ASSIGNMENTS

1. Why should business risks be assessed while evaluating the business idea?
2. List any two examples of risks, which a businessman may have to bear.
3. “A businessman has to be innovative”. Justify the statement.
4. Name two purposes for which a businessman may need fixed capital.
5. What are the benefits of product imitation?
6. Explain briefly the various sources from which business idea can be generated.
7. “A businessman should not keep his mind locked”. Do you agree? Give reasons.
8. How can business opportunities be assessed?

UNIT 5 MARKET ASSESSMENT

Structure

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Concept of Marketing
- 5.3 How to Assess Market for Any Business Idea
- 5.4 What Constitutes the Market for Your Business Idea
- 5.5 Market Size for Your Business Idea
- 5.6 Let Us Sum Up
- 5.7 Key Words
- 5.8 Some Useful Books
- 5.9 Answers to Check Your Progress Exercises
- 5.10 Assignments

5.0 OBJECTIVES

After studying this unit, you should be able to:

- get a clear view about the needs for market assessment;
- distinguish between needs and wants of the consumers;
- understand the meaning of market and marketing;
- identify and comprehend the process of market assessment;
- know about market segmentation and market targeting; and
- understand the market size for the business idea.

5.1 INTRODUCTION

Market assessment is referred to as an important step in the setting up of a business and its successful continuation. The key to success in a business lies in getting into the right business at the right time. This is easier said than done. Its accomplishment is difficult because good business opportunity tends to be elusive. Identification of such opportunities requires imagination, sensitivity to environmental change and realistic assessment of what the firm can perform.

Identification of opportunities and their assessment have been discussed at length in the previous unit. After the business opportunity is translated into an effective business idea, then starts the work of market assessment. You may note that before the commencement of any business (either a new business or the expansion of existing business) the need for assessment of market always exists. Need for market assessment will arise in:

- Survival of the business;
- Growth and development of the business;
- Diversification of the business;
- Desire for higher revenue;
- Facing competition
- Building brand recognition.
- Maintaining reputation and prestige of the business;
- Keeping customers;

- Changing tastes and fashions;
- Maintaining good relations with Government Departments and other relevant factors.

5.2 CONCEPT OF MARKETING

In this Unit we will study the various aspects of market assessment.

The concept of marketing cannot be understood in isolation. The meaning of marketing is inter-woven in the concept of human needs and wants, products, exchange process and the market. Let's start our journey of finding the meaning of the term marketing through these concepts.

Concept of needs and wants

Every human being living on this planet earth is a bundle of needs and wants. All of us –keep on working throughout the day in order to fulfil a purpose – the purpose being to satisfy various needs and wants.

What is a Need: A need is a state of felt deprivation of some generic satisfaction arising in the human conditions. People need air, water, food, clothing, shelter etc. These are basic needs, which have to be fulfilled for very survival. Man's needs are few and limited.

What is a Want: Wants are desires for specific satisfiers of the ultimate needs. A person needs food to survive but the same person may want a pizza, burger, cake or biscuits to satisfy his wants. A person may need water to quench his thirst but may want to have a drink of cola, apple juice, rose sherbet, tea or coffee.

As compared to man's needs, which are few and limited, his wants are unlimited. The list of wants is large and keeps on growing.

The wants of human beings are not static. They keep changing depending upon changing social patterns and life-styles, income etc. A person today may be contented with Maruti 800 but say, two years later the same person may want to own a Honda City or a Sonata.

Activity

In the following Table, three types of needs are given. Based on this, think and list four types of wants, which a person would like to fulfil.

| Needs | Wants |
|---------------------|----------------------|
| a) Men's clothing | 1. 2. 3. 4. |
| b) Women's clothing | 1. 2. 3. 4. |

| | |
|---------------|----------------------|
| c) Shelter | 1. 2. 3. 4. |
| d) Relaxation | 1. 2. 3. 4. |

Hint:

- A. Safari, Silken Kurta Pyjama, Designer Suit, Jeans
- B. Silk Saree, Leather Coat, Jamawar Shawl, Expensive Evening Gown
- C. Flat, Farm House, Big Bungalow, Haveli
- D. Dancing, Yoga, Meditation, Gym

Concept of product

A human being is in a position to satisfy his needs and wants through a product.

A product includes any object, service, activity or place through which a need or a want may be satisfied.

For example a product can be an 'object' like apple juice or it can be 'service' like showing of a play at a theatre or it can be an 'activity' like taking part in dancing during harvesting season, festivals etc. or it can be a 'place' like visiting 'tea gardens' at Palampur.

Concept of exchange

As already said, a person is in a position to satisfy his need through a product. How is the product to be made available to him? The product can be made available to any person through the process of exchange. The exchange can be through:

Barter: A person in need of wheat offers rice to another person and exchanges wheat for rice with him.

Money: For example, a hungry person may give money to get a cheese patty i.e exchange money for a cheese patty.

Getting a service: A person gets his clothes washed by another, giving him food in return.

After understanding these terms, we can now proceed to discuss what market and marketing mean.

Concept of market

The word market has its origin in the Latin word "Marcatus". It means merchandise, ware or trade. A market is the set of all actual and potential buyers of a product.

Traditionally, the term market was used to refer to a place where buyers and sellers met for exchange. But now, due to the growth and development of technology, buyers and sellers can conduct business without meeting at a place. Dealings can now be done through telephone, mail, Internet, etc.

Internet has no doubt created a revolution. It has given rise to a virtual market through which a seller can reach any customer anywhere, anytime; and so can the buyer reach the seller.

The term market in a wide sense is the set of all actual and potential buyers of a product. It takes into account the fact that whenever there is a need or a want and the wanted product is available for sale or exchange - a potential for trade: there is a market.

The term market can be looked upon from many directions.

Place of business: The term market, in common language, is used for a place where business is conducted. It is a place where customers go to purchase various goods to satisfy their needs and wants e.g. Lajpat Nagar market in Delhi and find sellers offering those goods for sale or exchange.

Nature of the products: The term 'market' may also suggest the nature of the product, which is traded there. For example, subzi market, cloth market, etc.

Volume of trade: The term 'market' is also at times used to indicate the volume of trade, which takes place between the buyer and seller. The place where goods are traded in bulk is called wholesale market and where goods are sold in small quantities is called retail market.

Concept of marketing

Marketing means working in and for markets. It can be referred to as an exchange transaction that takes place between the seller and the buyer. The needs and wants of the buyer and seller are met through the exchange transaction. Marketing is, therefore, a human activity directed at satisfying needs and wants through exchange process.

According to Philip Kotler, marketing is a "social process by which individuals and groups obtain what they want through creating, offering and freely exchanging products and services of value with others."

5.3 HOW TO ASSESS MARKET FOR ANY BUSINESS IDEA

A number of factors are to be considered for the assessment of the market (Figure 5.1). A businessman must take these factors into consideration while assessing the market. Following diagram depicts the factors affecting the assessment of market.

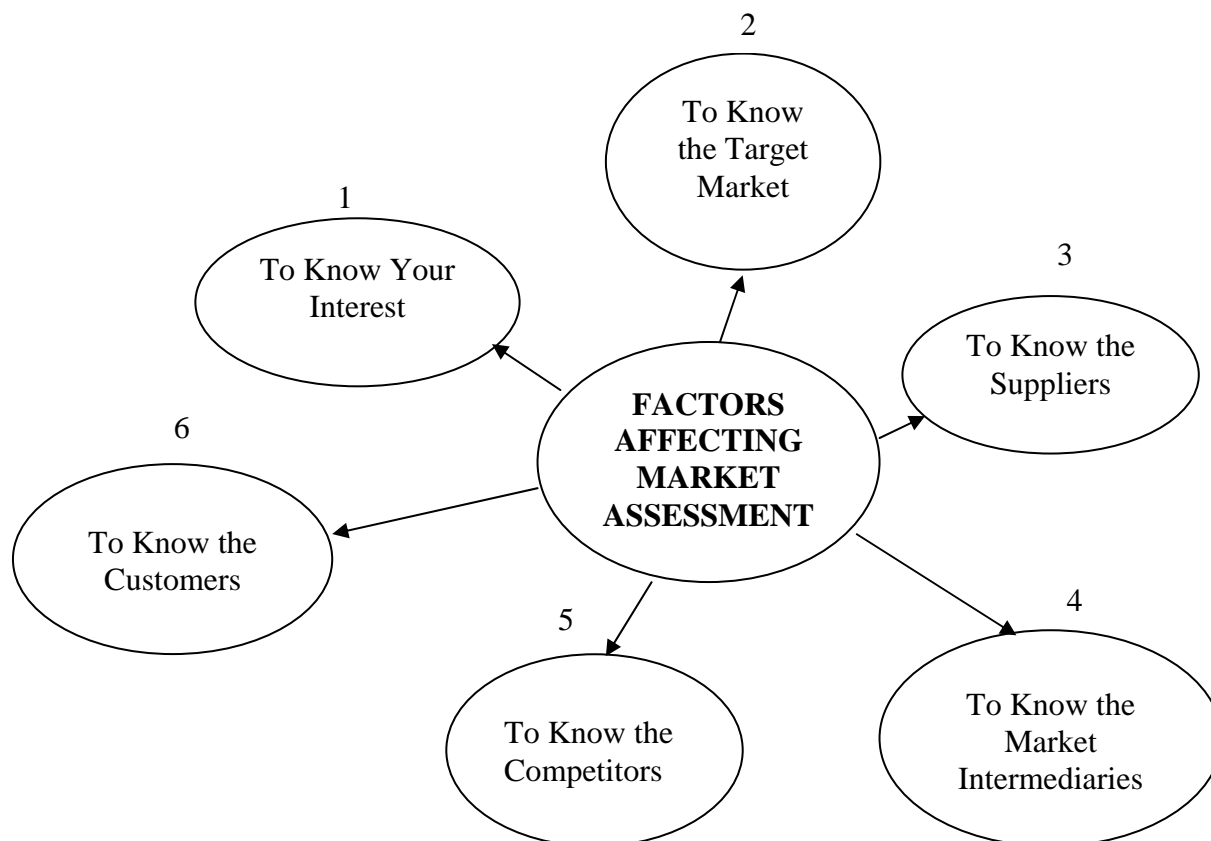


Figure 5.1: Diagrammatic presentation of factors affecting market assessment

Let's now discuss these factors:

1. To Know Your Interest

Before assessing the market, the businessman must first assess himself – he being a part of the market as well.

Have you ever pondered over whether all the people who thought of starting and running a good business were able to do so? Were they all successful in their mission to enter the market and then grow and develop, face the competition and so on.

Well, the answer is that a few businessmen did succeed in their objective whereas there were unlucky ones who did not. They could not muster any grip over the market, made wrong decisions and had unhappy experiences.

What were the consequences of the above-mentioned happenings? Gradually their business showed losses year after year and the saying “started with a boom and ended with a whimper” fully suited them.

Did these people really look into themselves before they started? Did they realize that they were poor planners or did not have an alert and dynamic mind, were visionless etc.

Because of their weaknesses resources (money, human workforce, natural resources etc.) got wasted leading to personal, social and national wastage.

Therefore it is the duty of every person who is thinking of starting a business to ask himself:

Setting up an Enterprise

- Is he really ready to face the market?
- Is he able enough to survive in the market?
- Can he plan a strategy to save himself from losing in the competition?
- Will he be able to fulfil all the economic, social, national objectives of entering business?

A businessman needs to have certain qualities. Some of the qualities may be inherent in his nature, whereas a few of them can be imbibed. Without these qualities, it will be difficult for a businessman – whether working on a small scale or large scale – to survive, grow and expand his business.

The qualities, which are very essential for any businessman are as follows:

Personal Qualities:

- Equable temper
- Pleasant behaviour
- Considerate nature
- Openness

Physical Qualities

- Good health
- Stamina
- Impressive personality

Mental Qualities

- Clear mind
- Confidence
- Enterprising
- Practical skills
- Rational judgment
- Good memory

Education and Training

- Minimum qualification required for that particular kind of activity
- Training in required skills
- Knowledge of business methods
- Knowledge about maintaining accounts and
- Complying with legal and government regulations

Qualities to Tackle Customers (Customer Oriented Qualities)

- Should act as a friend, philosopher and guide
- Maintain good interpersonal relations
- Have patience

Competition Oriented Qualities

- Dynamic
- Flexible
- Alert to opportunity
- Quick reflexes

- Creative
- Innovative
- Foresighted

Moral Qualities

- Honest
- Truthful

Managerial Qualities

- Good planner
- Rational decision maker
- Good motivator
- Good leader
- Good communicator
- Good listener
- Good organizer
- Careful – not rash
- Willing to accept challenges
- Risk taker

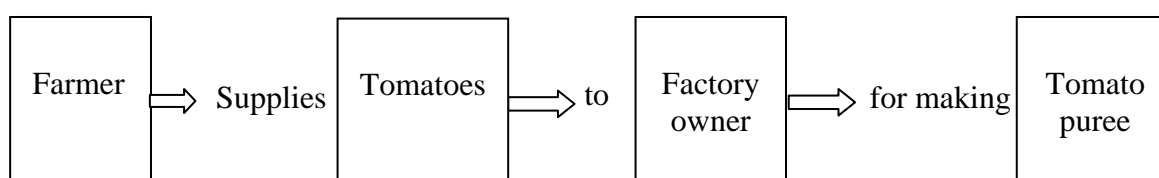
2. To Know the Type of Target Market

The businessman needs to decide on the market, which he wishes to cater to or enter. He may find two types of markets:

- Producer Market; and
- Consumer Market.

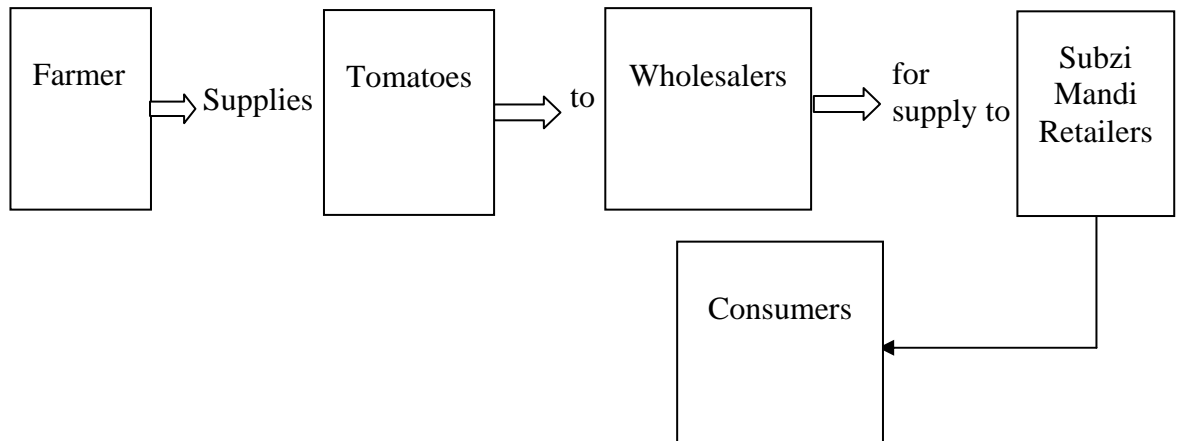
These are explained in the subsequent paragraphs.

- Producer market:* The goods supplied to industrial market are usually in the form of raw material and for further production not for final consumption. The raw material is processed and converted into finished product. It is then sold to the consumers. For example, tomatoes are processed in the factory, and converted into tomato puree. This process is depicted through the following diagram in which the farmer (i.e. businessman) supplies tomatoes (i.e. raw material) to the factory owner (i.e. industrial market) for converting into tomato puree (i.e. output):



- Consumer market:* The ‘consumer market’ comprises various consumers. The goods purchased from this market are for direct consumption. The buyer of the product is the final user. He purchases the finished product to satisfy his needs and wants. This process is depicted through the following diagram in which the farmer (i.e. businessman) supplies tomatoes (i.e. finished product) to wholesalers (i.e. middlemen) for further supply to subzi mandi (i.e. consumer market) and for final consumption by the consumers:

Setting up an Enterprise



3. To Know the Suppliers

The businessman in order to produce something must acquire a number of inputs needed in the production process. These are made available through a number of suppliers.

There are many kinds of suppliers for various inputs.

Input No. 1 – Money: There are various sources for arranging finance. The businessman can pool his own savings. Money can also be obtained from other sources like friends and relatives, commercial banks, co-operative societies, Regional Rural Banks etc.

Input No. 2 – Manpower (Human resources): The number and type of workers needed by a businessman depends upon the nature and scale of his business operation. A large-scale business may need clerical staff, managers, accountants, workers etc. whereas a small businessman may need only a couple of helpers.

Input No. 3 – Material: The businessman should know the type of material required to make the product. The businessman needs to deal with the suppliers of raw material. The raw material like oil seeds, cotton, fruits, vegetables and other agro-based products can be obtained from the cultivators or Agricultural Produce Market.

Input No. 4: Machines: The tools, equipment, machines etc. can be purchased directly from the manufacturers of these items or their agents. Some of the machines can be imported also depending upon the cost-effectiveness.

Input No. 5 – Information: The businessman needs to gather information as to the latest machines available or latest methods of production etc.

For a bird's eye view let's look at the following diagram, which shows the various types of suppliers. These are also known as five M's of marketing.

| | | | | |
|----------|----------|----------|----------|----------------------|
| M | M | M | M | M |
| E | A | A | O | E |
| N | T | C | N | T |
| | E | H | E | H |
| | R | I | Y | O |
| | I | N | | D |
| | A | E | | S |
| | L | | | (Information) |

(Five M's of Marketing)

The businessman should also keep in mind the strength of suppliers. At times, the suppliers of above inputs are in a dominant position and dictate their own terms and conditions to the businessman.

Activity

Roop and Swaroop are two close friends living in a small town of Uttranchal. They are planning to deal in following types of packed spices:

- Red Chili Powder
- Turmeric Powder
- Dhania Powder
- Chana Masala Powder
- Chaat Masala Powder

How will they assess their market in terms of their suppliers? The market assessment may be filled in the following Table:

| Sl. No. | Inputs | Decisions regarding the availability of inputs |
|----------------|---------------|---|
| A. | Men | 1. 2. 3. 4. |
| B. | Material | 1. 2. 3. 4. |

Setting up an Enterprise

| | | |
|----|---------|----------------------|
| C. | Machine | 1. 2. 3. 4. |
| D. | Money | 1. 2. 3. 4. |
| E. | Method | 1. 2. 3. 4. |

Hint:

- A. Production Manager, Marketing Manager, Workers etc.
- B. Red Mirchi, Turmeric, Dhania Seeds, Spices
- C. Grinding Machine, Sieves, Packing Machines, Other Tools and Equipment
- D. Own Savings, Funds from Friends and Relatives, Borrowings from Banks, RRBs
- E. Offices of SSI, Economic Survey of India, FICCI, CII, STC

4. To Know the Marketing Intermediaries

Marketing Intermediaries act as the middlemen or ‘go-between’ for the businessmen and the market i.e. the consumers. They help in the distribution of the output of the businessmen to the market. To make this clearer, let’s study the case of Neelam.

25-year old Neelam lived in Himachal Pradesh. She was a born painter. As a hobby, she made, lovely landscapes, portraits, other paintings using vegetable colours as the medium. To improve her standard of living, she thought of selling those paintings and soon thereafter, she along with her husband, started selling them to the rich families of nearby areas. Sale of the paintings was a morale booster for her. At this stage, an idea struck her mind. If she could make more paintings and sell them to a wider range of people? With full determination she started doing the work and in the next two months she made twenty-five beautiful paintings using vegetable colours. It was the time for the tourists to flock to these cool refreshing hill stations. Within a week’s time she and her husband were able to sell off all the paintings. This made them to earn an unimaginable figure of Rs. 15,000.

One of the tourists hailing from Delhi was greatly impressed by her paintings. Luckily, he was known to Neelam’s neighbours. He suggested to Neelam to sell the paintings in hi-fi shops of Delhi. He said that she would fetch a handsome price for these lovely creations of hers. Neelam and her husband liked the idea but there was nobody to guide them and help them in selling paintings in Delhi. This made them sad. But the tourist

solved their problem. He said that he was a very influential person and knew a lot about the market and people of Delhi. He could take her paintings to Delhi and sell them to the hi-fi shopkeepers on commission basis. Accordingly, the deal was made.

Now, who is this Mr. Tourist? What is his role in the entire process of exchange? Well, he is acting as an intermediary. He is the middleman between Neelam and the shopkeepers of Delhi, whom Neelam does not know.

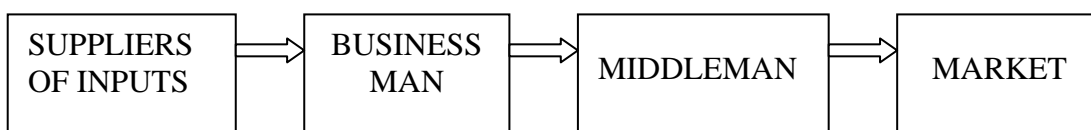
There are three kinds of intermediaries as explained below:

- i) *Merchant middlemen:* They are business units (like wholesalers and retailers). They buy, obtain title to the merchandise and sell them further.
- ii) *Agent middlemen:* They are the business units (like brokers and sales representatives). They negotiate purchase or sale of merchandise but do not take possession of title thereto.
- iii) *Facilitators:* They are business units that assist in the performance of distribution function. They neither take possession of title to goods nor negotiate purchase or sales of merchandise e.g. transporters, warehouses, bankers etc.

The businessman seeking distribution of his goods must either use established marketing intermediaries or set up his own system of distribution. The existing marketing intermediaries have the experience. However, if the businessman finds these intermediaries to be inadequate for his needs, he can establish his own network. Direct marketing can be the way to reach the final consumers through:

- Sales force
- Direct mail
- Telephone
- Internet

The role of intermediaries can be represented with the help of the following diagram:



5. To Know the Competitors

I think you'll agree with me if I say that a particular businessman is not standing alone as a seller in the market. There are others too in the trade.

For example Babu sells oranges on his 'Thela'. Now, is he the only person selling oranges? No, there are many others on the same street, in the colony or in the entire area.

The businessman must realize that other businessmen are also putting in equal amount of hard work, efforts, and dedication. There are a number of things, which the businessman should know, to compete with his business rivals or competitors. He should:

- Know about the number of firms in the same industry;
- Know about the market share of the top few firms;
- Know about the degree of homogeneity and differentiation in respect of his product;
- Know about the entry barriers operating in the market;
- Compare his product with the substitutes in terms of quality, price and appeal;
- Know about the market policies and practices.

The strength and weakness of the competitors also need to be found out and analysed. The businessman will compete most closely with those competitors who occupy a similar position or niche in the market. The businessman should therefore identify and monitor most closely those competitors who are seen to be close to him in the minds of the consumers.

6. To Know the Customers

Customers consist of all the individuals and households who buy or acquire goods and services for personal consumption.

There may be different types of customers in the market like old and young, poor and rich, illiterates and educated etc. The businessman should be able to distinguish different groups and develop products tailored to their particular needs. For example, a new type of custard powder or ice cream may be developed to attract the young generation.

With a view to knowing the customers, the businessman should ponder over the following aspects:

- *What do people buy?*

The customers may buy the following kinds of goods:

- i) **Durable Goods:** These are tangible goods, which can be used again and again, comparatively for much longer period of time. These may include furniture items, utensils etc.
- ii) **Non-durable Goods:** These are the goods, which are usually consumed in one go or are meant for few uses – say, fruits, vegetables, ketchup etc.
- iii) **Convenience Goods:** These goods are purchased very often for immediate use by the customers. The consumers will not compare the product with any other product before purchasing e.g. bread, buns, sugar, salt, food-grains etc.
- iv) **Shopping Goods:** These goods are purchased after due comparison with other products in terms of quality, price etc. e.g. tea, sherbets, shoes, cosmetics, furniture, etc.
- v) **Specialty Goods:** These are the goods, which have some unique features and brand identification. The buyer will make a special effort in purchasing these items e.g. Chocolate, sauce, Badam-Pista mixture, imported chocolates, ready-to-eat curries, olive oil,

Badam rogan, television, washing machine, car, imported fruits, etc.

Activity

Visit the nearby market in your area and gather the following information for completing the Table given below:

| Product | Available brand | Price | Size/weight |
|-----------------|-----------------|-------|-------------|
| Tea | | | |
| Strawberries | | | |
| Imported Fruits | | | |

- *When do consumers buy*

The businessman should analyse the timing of purchase. A consumer may buy a product frequently or the consumption rate may be low e.g. a family with young children may buy more of chocolates, potato chips etc. compared to roasted dalia.

The consumer may also buy at the time of festival e.g. sweets at the time of Deepawali, new clothes at the time of Rakshabandhan, rock salt and kutu atta during the 'Navratri days' when people keep 'fast', sewyan during Id, etc.

- *What do consumers want*

The consumers purchase goods to satisfy a variety of their needs. These needs may be physiological, spiritual, social, psychological, etc. Each product offers the buyers certain amount of utility. The customers weigh whether utility derived from the product matches the price paid by them.

- *How do consumers buy*

The businessman should study the buyers' decision-making processes that lead to a particular 'buying decision'. The businessman must try to understand the various cultural, social, and personal factors that operate to shape the life-styles of the customers. For example, in the case of apple jam, a person living in urban area may like to purchase it but the same may not appeal to a person who is living in rural area. A villager may like more to use mango chutney. Other factors, which may influence 'buying decision', include features of the product, its price, its quality, after-sales service provided by the seller, etc.

Buying process starts when the consumer feels the need for a product. Thereafter, he generally continues with the following buying process:

- i) In order to fulfil his needs the consumer seeks information from his environment. He tries to gather more awareness about the product that would satisfy his need;

- ii) The consumer after securing information develops an attitude – positive or negative – towards the product;
- iii) If a favourite attitude towards the product is developed, the consumer tries the product on a small scale;
- iv) Finally, if the trial is successful, he may buy the product – he may even become loyal to the product or brand.



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Read the following and answer the questions that follow:

“Raj Kishore has a mango garden in his village. He sells the mangoes grown in his garden to a firm of Sonapat namely, “Home-made Pickles” for making mango pickles..”

- i) Will the mangoes sold to “Home-made Pickles” be used by the owner of the firm and his family for personal consumption?

.....
.....
.....

- ii) Why is the firm buying the mangoes?

.....
.....
.....

- iii) If Raj Kishore plans to sell mangoes in the fruit market, who do you think will be the final users?

.....
.....
.....

2. Krishna Kumar wants to make and sell vegetable sauce. List the kind of workers, he will employ:

- i)
- ii)
- iii)
- iv)
- v)

3. Why has the businessman to identify and monitor his competitors?

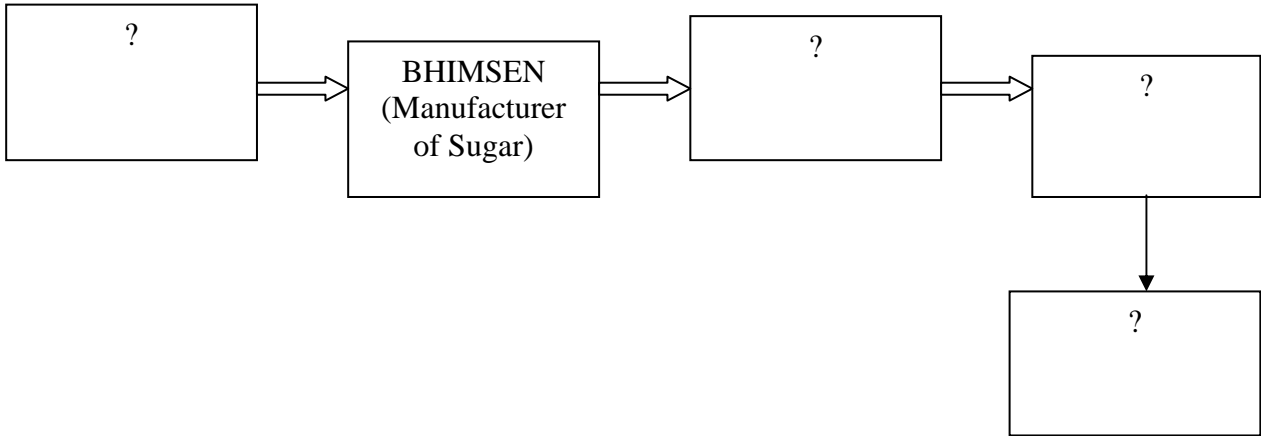
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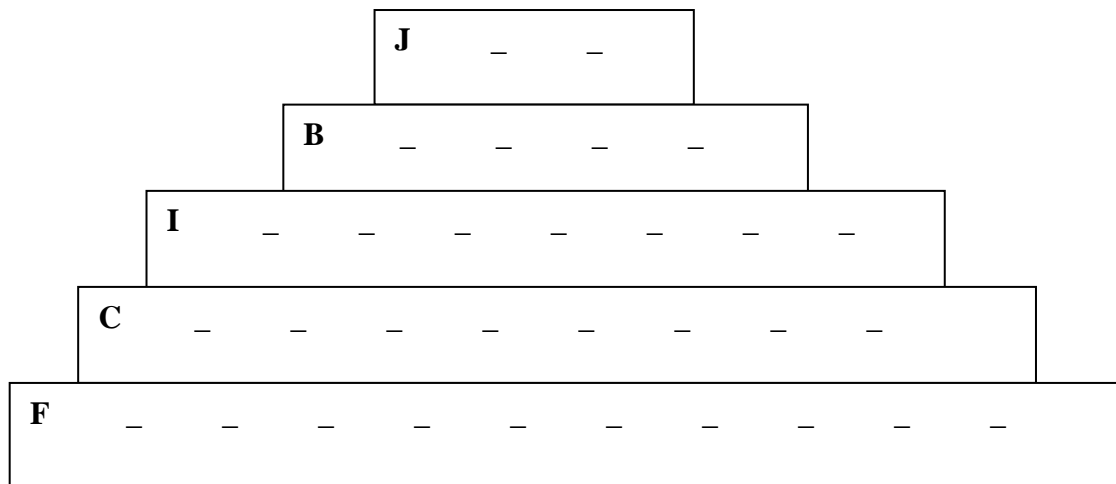
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4. Bhimsen is a businessman owning a sugar mill in District Meerut. Identify his suppliers of raw material, middlemen and the market and complete the process given below:



5. Fill the following pyramid on the basis of under-mentioned information:

- A business unit that assists in the performance of distribution. (11 letters)
- A source from where money can be arranged. (5 letters)
- A source of direct marketing. (8 letters)
- The individuals who buy goods for personal consumption. (9 letters)
- A sweet consumer product, which is manufactured using fruit as a raw material (demographic segmentation – small children). (3 letters)



5.4 WHAT CONSTITUTES THE MARKET FOR YOUR BUSINESS IDEA

Market consists of consumers. A market for any businessman comprises those persons who he thinks will buy his product. A businessman desiring to cater to the consumer market should understand the fact that consumers vary widely in their characteristics. They may differ in age, geographical location, income, education level, taste, product requirements, buying attitudes (a family may buy bananas only on Mondays), etc. Any of the above aspects can make a difference in customers' fancy or in the capacity of the firm to effectively serve that customer.

From the above it can be interpreted that the consumer market is not fully homogeneous but is heterogeneous in nature. The heterogeneous market can be broken down into a number of homogeneous units. This division of market is called market segmentation. The businessman through market segmentation, aims to satisfy the needs of the customers in a much better way. He tries to focus sharply on each of the different customer groups or any one of the customer groups within a market. Market segmentation leads to market targeting. In this Unit we will study about market segmentation and market targeting.

MARKET SEGMENTATION

A business unit normally is not able to serve all the customers. It may be due to the fact that there are too many customers in the market. Again, all of the customers are widely scattered. Moreover, some competitors will be in a better position to serve the customers in the market.

If the resources are limited, then the business unit should try to identify those market segments that it can best serve in terms of segment preferences, patterns of competition and the strength of the business.

There are many ways in which a market can be segmented. These are discussed below:

1. *Geographical segmentation (Geographical markets)*

In geographical segmentation, the businessman divides the market into different locations – neighbourhood towns, cities, districts, states, country and international markets. The businessman will target a particular geographical market keeping in mind the market potential and the costs incurred to reach the market e.g. Amul initially marketed its products only in Gujarat.

2. *Demographic segmentation*

Under demographic segmentation, the businessman divides his customers on the basis of age, gender, family size, city size, religion, language, occupation, educational level etc. For example, in the case of chocolates and beverages, the target customers are young children and adolescents.

3. *Buying behaviour segmentation*

Under buying behaviour segmentation, customers are divided on the basis of purchase decisions made by them. The idea behind this is that different customer groups expect different benefits from the same product and as such their motivation in owning it and their behaviour in buying it will be different.

4. *Benefit segmentation*

Under benefit segmentation, the consumers are classified according to the benefits they derive from the product. For example, benefits derived from 'Amla Murabba'.

5. *Volume segmentation*

The quantity of purchase is another basis used for dividing the customers. There may be bulk buyers, small-scale buyers, regular buyers and one-time buyers.

6. *Economic segmentation*

Under economic segmentation, customers are divided on the basis of their income level. For example, Mother Dairy ice creams are available in different price ranges so that anybody according to his income level may purchase the same. In bakery shops we may find a variety of cakes like vanilla cake, chocolate cake, truffle cake, etc. A customer may buy a particular cake, which suits his income level.

7. *Psychographic segmentation*

This kind of market segmentation is done on the basis of customers' attitude, opinion, interests etc. or a combination thereof.

MARKET TARGETING

Market segmentation leads to market targeting. Market targeting is the process of fixing target market.

You may note that process of market segmentation opens up not one but several market segments. These segments will have varying potential, profitability and the degree of risks. The firm must evaluate the worth of each segment in terms of whether it is sizeable, accessible, attractive and profitable. The firm may not be interested in all the segments. Some may give high profitability but may need heavy initial investments. Some may have potential but the firm may face tough entry barriers. Thus, the firm needs to select one or more segments as the target market. The segment selected as target market must be most appropriate to the firm. This is what constitutes the market for a particular business idea.

With the help of market targeting, the businessman is in a position to identify the markets and the group of target customers for whom he plans to produce products. Market targeting is the act of evaluating and comparing different identified groups. After evaluation and comparison the businessman may select one or more of the identified groups as the prospective customers with the highest potential. Thereafter a suitable marketing mix may be devised that will give the best return on sales.



Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. State True or False:
 - i) The businessman must look at each market segment as a distinct marketing opportunity.
 - ii) Market segmentation must be relevant and profitable to the businessman.
 - iii) Market targeting leads to market segmentation.
 - iv) Consumer market is fully homogeneous.
 - v) Target market can be fixed at random.

2. Match the following:

| | |
|----------------------|----------------------------------|
| i) Location | A) Economic segmentation |
| ii) Age | B) Geographical segmentation |
| iii) Quantity | C) Buying behaviour segmentation |
| iv) Income level | D) Demographic segmentation |
| v) Purchase decision | E) Volume segmentation |

3. 'Swadeshi Beverages (Pvt.) Ltd.' is planning to launch a health drink for old people. On which base would they segment their market?

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5.5 MARKET SIZE FOR YOUR BUSINESS IDEA

Meaning of market size

Market size means the actual volume that is currently being purchased by the customers. It can be measured in terms of rupees or units. It is always smaller than the total market potential.

Meaning of total market potential

Total Market Potential is the maximum amount of sales that might be available to all the firms in an industry during a given period under a given level of

marketing effort and given environmental conditions. It is also measured in rupees or units.

Assessment of market size

Assessment of market size depends upon the following two factors:

i) **Market demand:** This means the total volume that would be bought by a customer in a defined time period. A product should have a demand in the market. A demand is said to be there when a person has some interest in that product and he also has the purchasing power i.e. necessary resources for purchasing the product.

To assess the market size, the businessman should undertake *demand forecasting*. Some of the methods, which a businessman may use for demand forecasting, are:

- *Survey method:* Under this method the businessman tries to gather information in respect of demand for his product. In this connection he obtains information from sales representatives, prospective customers, suppliers, experts etc. Based on the information collected, he calculates the demand for his product.
- *Leading indicator method:* Some leading indicators may show the trend of future. Now-a-days frozen vegetables (like peas) have a huge demand. This being a leading indicator, the supplier of packaging material, in which the frozen vegetables are packed, may anticipate that there will be huge demand for packing material also.
- *Statistical methods:* Certain statistical methods like multiple regression analysis and time series may be used to forecast the demand.

ii) **Price:** The size of the market will vary with price. A high price of a product may create a small market whereas a low price of the product may fetch a larger market. This is due to the fact that more people can afford to purchase the product.

Check Your Progress Exercise 3



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Fill in the blanks:

- i) ----- is the maximum amount of sales that might be available to a businessman.
- ii) ----- is the actual volume that is currently being purchased.
- iii) A product should have a ----- in the market.
- iv) High price shall have ----- market.
- v) ----- is the total volume that would be bought by the consumers.

2. Name any one unit of measurement, which may be used to measure the market size.

.....
.....
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.....
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5.6 LET US SUM UP

For setting up a business and its successful continuation, market assessment has an important role to play. Before understanding the term market assessment, it is a must to understand concept of needs and wants, concept of product, concept of exchange, concept of market and concept of marketing. A number of factors affect market assessment. These factors include knowledge of self (i.e. self-assessment); knowledge of the type of target market; knowledge about the suppliers; knowledge about the intermediaries; knowledge about the competitors, and knowledge about the consumers. Market consists of consumers. Consumer market is not fully homogeneous but is heterogeneous in nature. The heterogeneous character of the market may be broken down into a number of homogeneous units and this kind of division of market is called market segmentation. Market can be segmented on the basis of geographical segmentation, demographic segmentation, buying behaviour segmentation, benefit segmentation, volume segmentation, economic segmentation and psychographic segmentation. Market segmentation leads to market targeting. With the help of market targeting, the businessman can identify the market and the group of target customers. Market size also plays an important role. Assessment of market size depends upon market demand and the price of the product.

5.7 KEY WORDS

- Market segmentation** : Division of market on certain bases.
- Product** : Any object, service, activity or place which helps in satisfying a need or a want.
- Wholesaler** : A middleman who purchases goods from the manufacturers in bulk and sells to the retailers.
- Retailer** : A middleman who purchases goods from the wholesalers and sells to the ultimate consumers.



5.8 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

Your answer should include following points:

1. i) No ii) For making pickles iii) Consumers

2. i) Persons in the factory ii) Clerical staff iii) Accountant
iv) Receptionist v) Marketing Manager
3. To gain and maintain loyalty of the consumers.
4. Farmer; Wholesalers; Retailers; Consumers
5. Words to be filled in the pyramid are:
 - Facilitator
 - Banks
 - Internet
 - Consumers
 - Jam

Check Your Progress Exercise 2

1. i) True ii) True iii) False iv) False v) False
2. i) B ii) D iii) E iv) A v) C
3. Demographic

Check Your Progress Exercise 3

1. i) Market potential
ii) Market size
iii) Demand
iv) Small
v) Market demand
2. Rupees

5.9 SOME USEFUL BOOKS

1. Gupta, C.B. and Rajan Nair, N. (2000) Marketing Management, Sultan Chand and Sons, New Delhi.
2. Kotler, Philip (2004) Marketing Management – Analysis, Planning and Control, Prentice Hall of India, New Delhi.
3. Ramaswamy, V.S. and Namakumari, S. (1998) Marketing Management (Planning, Implementation and Control – The Indian Context), Macmillan India Limited, Delhi.
4. Varshney, R.L. and Gupta, S.L. (2000) Marketing Management (An Indian Perspective); Sultan Chand and Sons, New Delhi.

5.10 ASSIGNMENTS

1. Elaborate the term ‘market’ and ‘marketing’.
2. Mention in brief the procedure, which a consumer may follow in buying the product.
3. What is the difference between wholesalers and agents?
4. What is Market Segmentation? In which ways can a market be segmented?

**Setting up an
Enterprise**

5. Classify the following products into convenience goods, shopping goods and specialty goods:
 - i) salt
 - ii) sugar
 - iii) shoes
 - iv) air conditioners
 - v) clothes
 - vi) bread
 - vii) cars
6. Explain the following:
 - i) Geographical Segmentation;
 - ii) Demographic Segmentation
7. Distinguish between convenience goods and specialty goods on the basis of price and sale effort.
8. Name the two factors on which the size of market depends.
9. Enumerate the various qualities, which a businessman needs to assess himself.
10. Explain briefly the methods of demand forecasting.

UNIT 6 WHAT DOES MARKETING INVOLVE?

Structure

- 6.0 Objectives
- 6.1 Introduction
- 6.2 Marketing Functions
- 6.3 What is Marketing Mix?
- 6.4 Marketing Mix – Product
- 6.5 Marketing Mix – Price
- 6.6 Marketing Mix – Promotion
- 6.7 Marketing Mix – Place (Distribution)
- 6.8 Let Us Sum Up
- 6.9 Key Words
- 6.10 Answers to Check Your Progress Exercises
- 6.11 Some Useful Books
- 6.12 Assignments

6.0 OBJECTIVES

After studying this unit, you should be able to:

- refresh the understanding of marketing;
- identify the various marketing functions;
- understand the concept of marketing mix;
- comprehend and analyse the 4 P's of marketing mix; and
- apply the elements of marketing mix to the practical world.

6.1 INTRODUCTION

Marketing, as you are all aware of, starts with the consumer and ends too, with the consumer. The businessman takes the consumer to be the king and therefore, the consumer becomes the focal point of all of his marketing decisions. The businessman has become sensitive to the attitudes of the consumer. He therefore, tries to materialize his goals through consumer satisfaction.

Marketing is the central function of any business. The entire business is organized around the marketing function. The businessman emphasizes identification of market opportunity and seeks to convert customer “needs” into “products”. The entire business is a customer satisfying process.

The businessman has to get involved in a number of activities to satisfy his customers and thereby earn profit. Marketing consists of all those activities, which involve working through markets. It covers all those activities and processes by which the products are matched with the market. Marketing functions refer to a series of specialised activities involved in the marketing of goods and services.

Let's try to understand these marketing functions in the subsequent paragraphs.

6.2 MARKETING FUNCTIONS

Production of goods by the business gains importance only when they are sold. Marketing enables a businessman to sell his goods to the consumers.

The functions of marketing make goods and services of use to the society by creating form, place, time and possession utilities. Goods are to be processed into different forms to suit the needs of the consumers, creating thereby the form utility. Goods are required to be transported from the place of production to the place of consumption, thereby creating place utility. Surplus goods are also required to be stored in warehouses for deferred consumption, thereby creating time utility. Sale and transfer of goods create possession utility.

The functions of marketing may be broadly divided into three categories:

- I) Functions of Exchange;
- II) Functions of Physical Supply; and
- III) Facilitating Functions.

The diagrammatic presentation of marketing functions (Fig 6.1) is as follows:



Figure 6.1: Diagrammatic presentation of marketing functions

Let us now discuss these functions in detail.

I. Functions of exchange

The functions of exchange include activities performed in the transfer of ownership from sellers to buyers. They include:

- 1) Buying
- 2) Assembling
- 3) Selling

1) *Buying function:* A marketer is engaged in the process of transformation. He takes inputs from the environment, converts them into a finished product and then supplies it back to the environment. Buying involves transfer of ownership of the product from seller to buyer.

A manufacturer buys raw material from the suppliers for using the same in producing goods whereas a trader procures finished goods from the various manufacturers. A trader can be a wholesaler or a retailer. A wholesaler buys the goods for resale to retailers whereas a retailer buys the goods for resale to the ultimate consumers. Efficient buying is very important for success in marketing.

Goods can be sold at a profit only when they are of right quality and quantity. The following points, known as five R's of best buy, should be kept in mind before any purchase:

- Right source
- Right quantity
- Right quality
- Right price
- Right time

2) *Assembly function:* The work of assembly begins only after the goods have been purchased. It implies gathering of products purchased from different producers/manufacturers at some central place. Some times firms assemble goods in big lots, grade them and give their own brand name after packing the goods.

For example, Niharika Agro Products purchases rice from various farmers, grades them according to the quality, packages in small lots, gives a brand name (Raja Chawal) and sell it to the wholesalers.

3) *Selling function:* Selling is a very important function of marketing. It is vital to the success of any firm because the revenue is earned by the businessman through selling. The businessman on the one hand, earns profits while on the other hand, he makes available the goods and services to the consumers. Selling can be defined as “effecting transfer of ownership in goods by the seller to the buyer in exchange for money”.

Selling involves many activities like locating buyers, finding their preferences, persuading them to buy, negotiating the terms of sale, receiving payment and making delivery, and providing appropriate after sale services.

An enterprise may sell goods directly or through agents, wholesalers and retailers.

II. Functions of physical supply

The functions of physical supply refer to the activities involved in the physical movement of the goods. These functions are:

- i) Transportation
- ii) Storage (i.e. warehousing)
- iii) Inventory management
- iv) Order processing
- v) Delivery

The details of these functions are given as under:

i) *Transportation*: Transportation is physical movement of material and goods from one place to another. The function of transportation is quite important because goods are not consumed at the place of their production. Customers are located at far away places. Therefore, goods have to be transported. Transport serves as a link between the producer and the consumer. Proper arrangement for the transportation of the product to market is important to the process of marketing. Transport helps to widen the market; to increase the scale of production and to stabilize the prices. The essence of transportation is that the right product reaches the right destination at the right time. Transportation includes decisions like:

- Choice of mode of transport
- Route planning
- Freight consolidation
- Vehicle scheduling

It may be noted that choice of mode of transport depends upon relative costs of different modes, their speed, reliability, frequency etc. Road transport is suitable for short distances and for rough terrains like mountains. Rail transport is ideal for bulky goods and also if the goods are to be sent over long distances. When goods are costly or of perishable nature and where speed counts, air transport should be preferred. Water transport is the cheapest but it slower.

The various means of transport can be depicted in the following diagram (Fig 6.2):

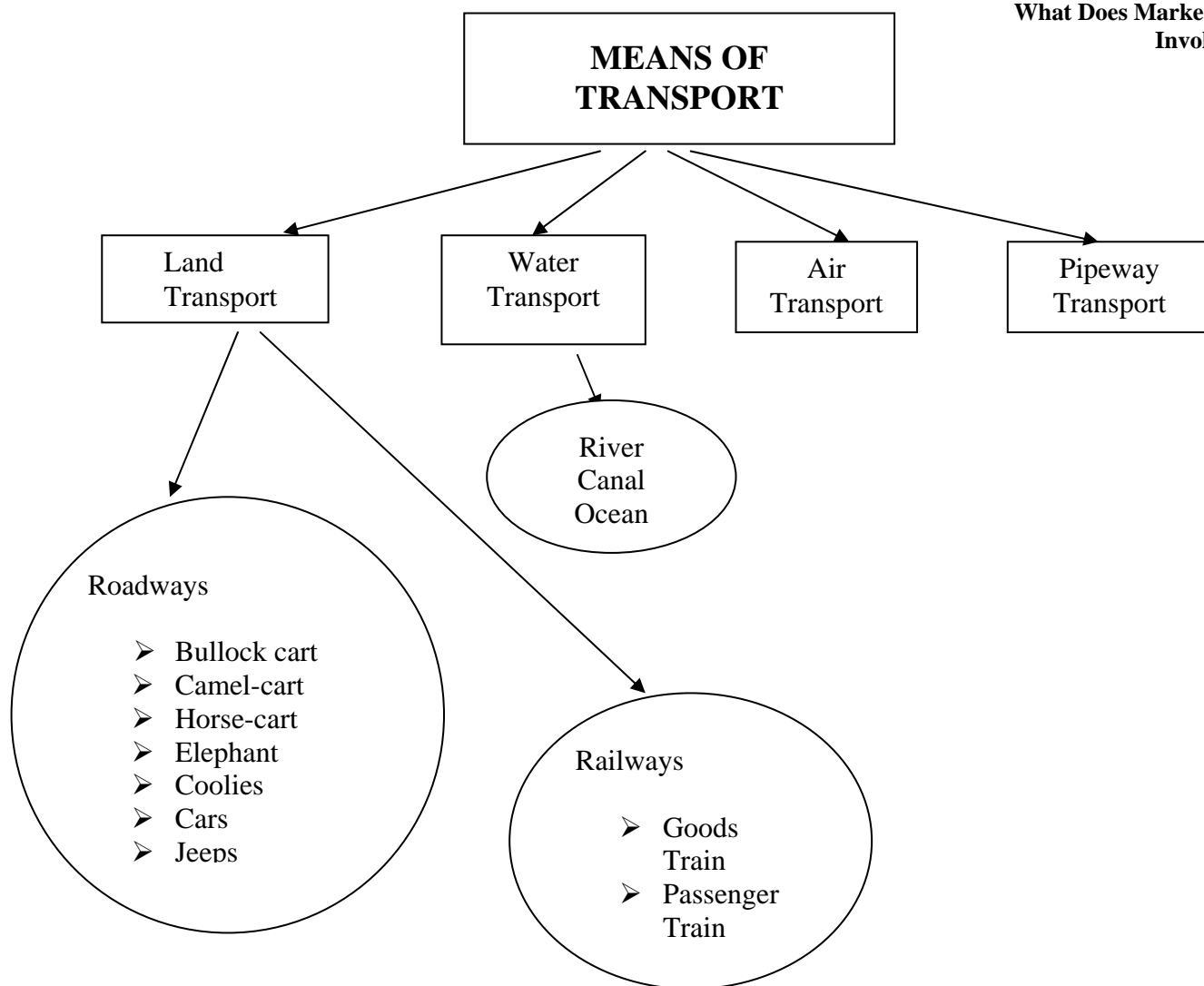


Figure 6.2: Diagrammatic presentation of means of transport

Activity

Tick the appropriate option:

| Particulars | Road | Railways | Water | Air |
|---|------|----------|-------|-----|
| 1. Amarnath wants to transport 100 quintals of rice from Bihar to Rishikesh in Uttranchal. | | | | |
| 2. Vinay wants to transport 10 quintals of wheat from Ghaziabad to Bulandsahar. | | | | |
| 3. Ram Singh wants to transport 500 tons of sugar to London | | | | |
| 4. Suraj Nath plans to send 500 kilos of onions from Azadpur Mandi to Okhla Mandi (both places are in Delhi). | | | | |
| 5. Sham Lal wants to send 100 kgs. of rose flowers from Delhi to Chennai. | | | | |

(Hint: 1. Railways; 2. Road; 3. Water; 4. Road; 5. Air)

ii) *Warehousing*: Another function of marketing process is warehousing. It involves the making of proper arrangements for retaining the goods in a perfect state till the time consumers need them for consumption. Warehousing function is important because there is usually a time lag between production and consumption. With the help of warehouses where goods are stored, uninterrupted supply is maintained so that there is no inconvenience to the user and there is stability in prices. Modern warehouses provide facilities for packing, blending, grading, labelling etc. of stored goods. A manufacturer can secure wider distribution of goods by holding stock at different places. Further the goods get protected from the following risks:

- Fire
- Theft
- Leakage
- Pests, rodents and insects
- Weather changes
- Moisture

The owners may maintain their own warehouses or take the services of warehousing companies. Perishable products like fruits, vegetables etc, are stored in cold storages.

Benefits of warehousing

There are a number of benefits in warehousing. These are:

- Goods can be manufactured or processed in bulk and stored.
- Goods can be stored safely in warehouses.
- It helps in making available the product to the buyers as and when needed.
- It helps in maintaining price stability by adjusting supply with the demand.
- It helps in purchasing goods from far off places as well.
- Commercial banks make available loan on the security of warehouse receipts.
- More imports are possible.
- It facilitates exports.

iv) *Inventory management*: The firm needs to maintain a particular level of stock to ensure product availability as and when customers demand. Holding of inventory involves cost of storage, cost of capital tied up in inventory, cost of adverse price movements, cost of spoilage etc. Inventory control implies control over the size of the inventory. The business firm should weigh the benefits of maintaining inventory against the cost and optimum level should be decided.

iv) *Order processing*: The following steps may be taken to process the order:

- Receipt of order.
- Acknowledgement/Acceptance sent to the customer on receipt of order.
- Customer credit check.
- Inventory scheduling i.e. collection, packing etc.
- Dispatch of goods.

Facilitating functions refer to the activities involved in helping the process of exchange (Figure 6.3). Following are some of the important functions, which facilitate buying and selling of goods. Every trader is required to take these steps judiciously and carefully.

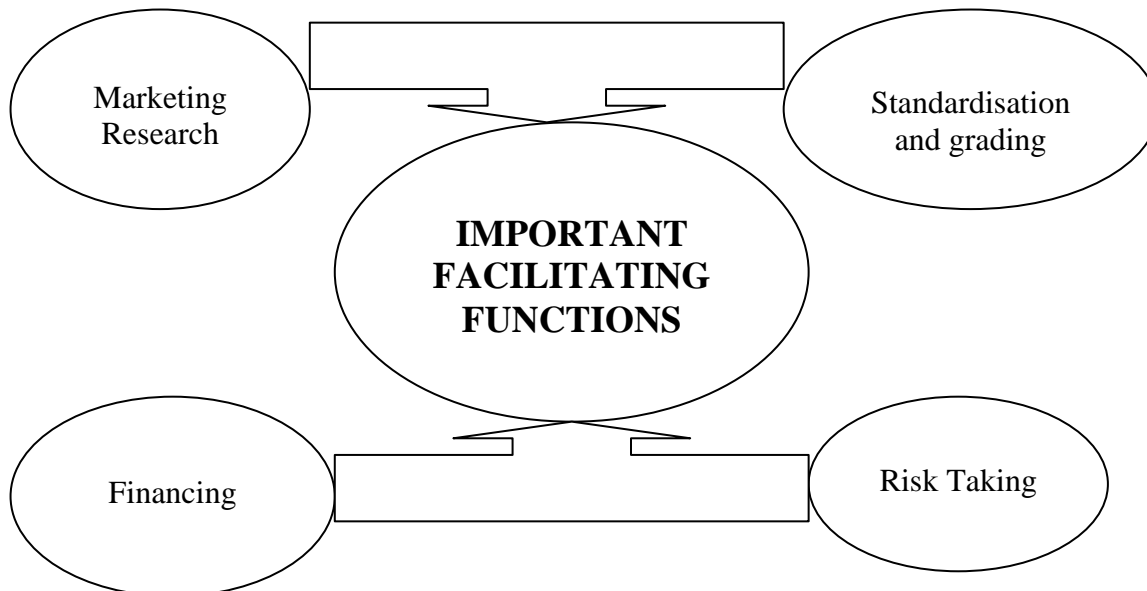


Figure 6.3: Diagrammatic presentation of important facilitating functions

1) *Marketing research*

American Marketing Association has defined Marketing Research as “gathering, recording and analysing of all facts about any problem relating to the transfer and sale of goods and services from the producer to consumer.”

The term ‘marketing research’ means application of research process in solving marketing problems. Marketing Research equips the marketer in taking all-important decisions correctly. It provides the right information at the right time in the right place and to the right person, which is vital in decision-making.

Uses of marketing research

A businessman can conduct marketing research for the following purposes:

- a) *To recognise the needs of the customers:* Marketing Research can be used to identify the various needs and wants of the customers. It involves the study of the market and the customers.
- b) *To understand the buying motives:* Marketing Research can be used to understand buying motives of the customers. A customer may buy a product for more than one reason, protection, style, status etc.
- c) *To decide the brand name:* A product should have a suitable name. An attractive name always fetches plenty of customers and helps in bringing reputation to the firm. The manufacturer should conduct proper marketing research to decide the brand name of the product.

- d) *To decide the size of the package:* The size of the package should be the one, which is convenient in lifting, carrying and storing. A proper size of the package enables proper handling of the product. Ideal size can be ascertained through marketing research.
- e) *To decide the method of advertisement:* Advertisement has a great impact on the minds of the customers especially children and adolescents. A good advertising campaign certainly leads to high profits. Marketing Research helps the businessman in deciding the suitable method of advertising.

Classification of marketing research problems

The various marketing research problems can be classified based on the subject matter of research as shown below:

- a) *Research on Product:* It includes:
- Reviewing product line, product quality, product features etc.
 - Study of the actual uses of a given product;
 - Study of the new uses of an existing product;
 - Study of packaging, packing material etc.
 - Testing of new products.
- b) *Research on Markets:* It includes:
- Study of the market size;
 - Study of the market segments;
 - Short range and long range sales forecasting;
 - Study of the overall business trend;
 - Analysis of market share.
- c) *Research on consumers:* It includes:
- Study of consumer profile;
 - Study of the consumer tastes;
 - Study of the consumer brand preferences;
 - Study of consumer dissatisfactions;
 - Study of the consumer reactions.
- d) *Research on Advertising and Promotion:* It includes:
- Media research;
 - Assessing the impact of advertisement;
 - Assessing the effectiveness of sales promotion measures;
 - Cost benefit analysis.
- e) *Research on Distribution:* It includes:
- Measuring relative effectiveness of different types of distribution intermediaries;
 - Measuring dealers' reaction to the firm;
 - Measuring warehouse efficiency.
- f) *Research on Pricing:* It includes:
- Assessing the general pattern of pricing followed by the industry;
 - Evaluating the pricing strategy of the firm;
 - Measuring price elasticity of demand.

g) *Research on Sales Methods*: it includes:

- Testing new sales programmes;
- Analysing problems of selling;
- Measuring the effectiveness of salesmen;
- Study of sales compensation.

h) *Research on Competition*: It includes:

- Study on competitive structure of the industry;
- Study on the competitive structure of the individual competitor;
- Study of competitor's product, prices;
- Study of the competitor's promotion programme, channels policies, etc.

Steps involved in marketing research

The researchers have to go through several steps in order to apply marketing research to solve any marketing problem. The major steps are as follows:

1. *Defining and Analysing the problem*: The marketing problem should be clearly identified and defined. If the definition of the problem is faulty the research results will be misleading e.g. research should be conducted to analyse the effectiveness of advertisement.
2. *Developing a research design*: After the marketing problem has been clearly defined, the researcher should develop a proper research design. He should decide on how to collect data, the various research instruments to be used, sampling plan etc.
3. *Collection of data*: Data is the foundation of all marketing research. Data can be primary data or secondary data.

Primary data is the data collected by the researcher himself and that too for the first time. It can be collected through salesmen, dealers, consumers etc. The researchers can also refer to the reports like sales turnover reports, advertising reports etc. The important reports can be collected through various research instruments like tape recorder, cameras, questionnaires, telephone interviews, e-mails etc.

Secondary data is the data collected earlier by some other agency or body and used by the researcher. It can be gathered through magazines, journals, government publications, annual reports of companies, etc.

4. *To analyse the data collected*: The next step is to extract meaningful information from the data collected. It can be done through:
 - Averages;
 - Measures of dispersion;
 - Measures of correlation and co-efficient of variation;
 - Goodness of fit.

5. *Report preparation and implementation:* This is the last step in the research procedure. The major findings and recommendations, which are inferred from the study, should be properly prepared.

The findings should be written in concise, succinct simple and clear language. It can be supported with graphs, tables and examples .It should then be properly presented, thoroughly discussed and decision should thereafter, be taken rationally.

Activity

You are required to fill the following questionnaire after interviewing at least 5 consumers regarding their tastes and preferences in respect of consumption of potato chips. You may use Photostat copies of the questionnaire.

1. Name:
2. Age:
3. Sex: Male Female
4. Address:
5. Questions:
 - Self-employed Housewife
 - Govt. employee Private Sector employee
 - Student Any other, Specify_____
6. Monthly Income:
 - Below Rs. 5,000 Rs. 5,000-10000
 - Rs. 10,000-15,000 Above Rs. 15,000
7. Do you consume potato chips? If yes, how frequently:
 - Less than 3 days in a week
 - Between 3-5 days in a week
 - Above 5 days in week
8. Which flavour of potato chips do you like most?
 - Plain salted flavour Chilly flavour
 - Masala flavour Tomato flavour
9. How much importance do you give to a brand while asking for a packet of potato chips?
 - Quite a lot Medium
 - Not much

10. Which brand of potato chips do you like the most? (Rank your preferences):

- Ruffle Lays Uncle Chipps
 Cheetoes Haldiram
 Any other, Specify _____

11. What aspect do you consider most while choosing potato chips?

- Brand name Quantity
 Taste Price
 Colour of the Pack Free gift inside the pack
 Advertisement of the manufacturer

2) *Standardisation and grading*

- a) *Standardisation*: Standardisation means production of such goods as will be uniformly of the same specifications with regard to shape, size, colour, material, performance etc. If the goods are not standardised it will have a negative impact on the minds of the consumers. The customers will lose faith and trust in the product and may shift to an other brand. The uniform specifications should be such that the customer is not required to examine the product each time before purchasing it.
- b) *Grading*: Grading is division of product into classes made of units possessing similar features of size, shape, colour and quality. Grading is usually done in raw materials and agricultural products. For example, rice, wheat pulses, fruits, vegetables, eggs etc. are graded.

3) *Financing*

The role of finance in any business cannot be under-estimated. Finance acts as a lubricant, which makes the wheels of business move faster and faster. Finance is required for marketing the various goods and services. A businessman may need finance for short-term purposes or long-term purposes. Short-term purposes may include paying salary to salesmen or paying expenses on conducting surveys etc. Long-term purposes may include purchasing of computers or constructing a godown or purchasing vehicles for delivering goods etc.

The various sources of finance are:

- Own Capital
- Friends and relatives
- Commercial banks
- Co-operative banks
- Agricultural credit societies
- Government agencies etc.

4) Risk taking

Business risks refer to the possibility of inadequate profit or even losses due to unexpected events, which are beyond control. Risk is part and parcel of business. There are plenty of risks involved in any business. Risks arise due to unforeseen circumstances, natural calamities, wrong planning, irresponsible human behaviour etc. An enterprise has to bear innumerable risks in the process of marketing goods and services. Some of the examples are as below:

- Risk due to fire
- Risk due to theft and negligence
- Accidents
- Change in government policies
- Drought, famine, lightning and earthquakes
- Wrong estimation
- Change in tastes and fashion
- Technology changes
- Trade cycle risks etc.



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Give one word for the following:
 - i) A process of transferring of ownership of the product from seller to the buyer.
 - ii) Movement of men and material from one place to another.
 - iii) Activities involved in helping the process of exchange.
 - iv) A place where storing is done.
 - v) Possibility of losses due to unforeseen circumstances.
2. Match the following:

| Type of product | Mode of transport |
|--------------------|-------------------|
| 1) Logs of wood | A) Air plane |
| 2) Imported Fruits | B) Elephants |
| 3) Coal | C) Water |
| 4) Wood-planks | D) Train |
| 5) Sugar bags | E) Lorry |

3. Give two examples for each of the following:
 - i) Products which can be graded;
 - ii) Short-term finance required;
 - iii) Primary Data (source)

- iv) Research instruments;
- v) Means of Road transport.

- i)
- ii)
- iii)
- iv)
- v)

4. Warehousing is important because:

- i)
- ii)
- iii)

5. What kind of research can be done on products and consumers? Mention two points each.

Products:

- i)
- ii)

Consumers:

- i)
- ii)

6.3 WHAT IS MARKETING MIX?

The business firm usually develops a marketing plan to achieve its various marketing objectives. Developing a plan is becoming more and more important keeping in view the ever expanding global scenario, tight competition, changing needs and wants of the customers, technological changes etc.

Marketing mix is a plan designed to analyse the marketing problems. In fact, marketing mix is the ingredients or variables, which the marketer mixes in order to interact with a particular market.

Marketing mix is the term used to describe the combination of four inputs, which constitute the core of a firm's marketing programme. The four areas are as follows:

- Product Mix
- Price
- Place (Distribution)
- Promotion

These are popularly known as four P's of marketing mix (Figure 6.4).



Figure 6.4: Diagrammatic presentation of 4 p's of marketing mix

The idea behind development of a marketing mix is to have greater consumer satisfaction. Marketing mix refers to various decisions taken in the context of product, price structure, promotional activities and the distribution system. A bird's eye view of these decisions, being sub-elements of 4 P's of marketing mix, is depicted in Figure 6.5.

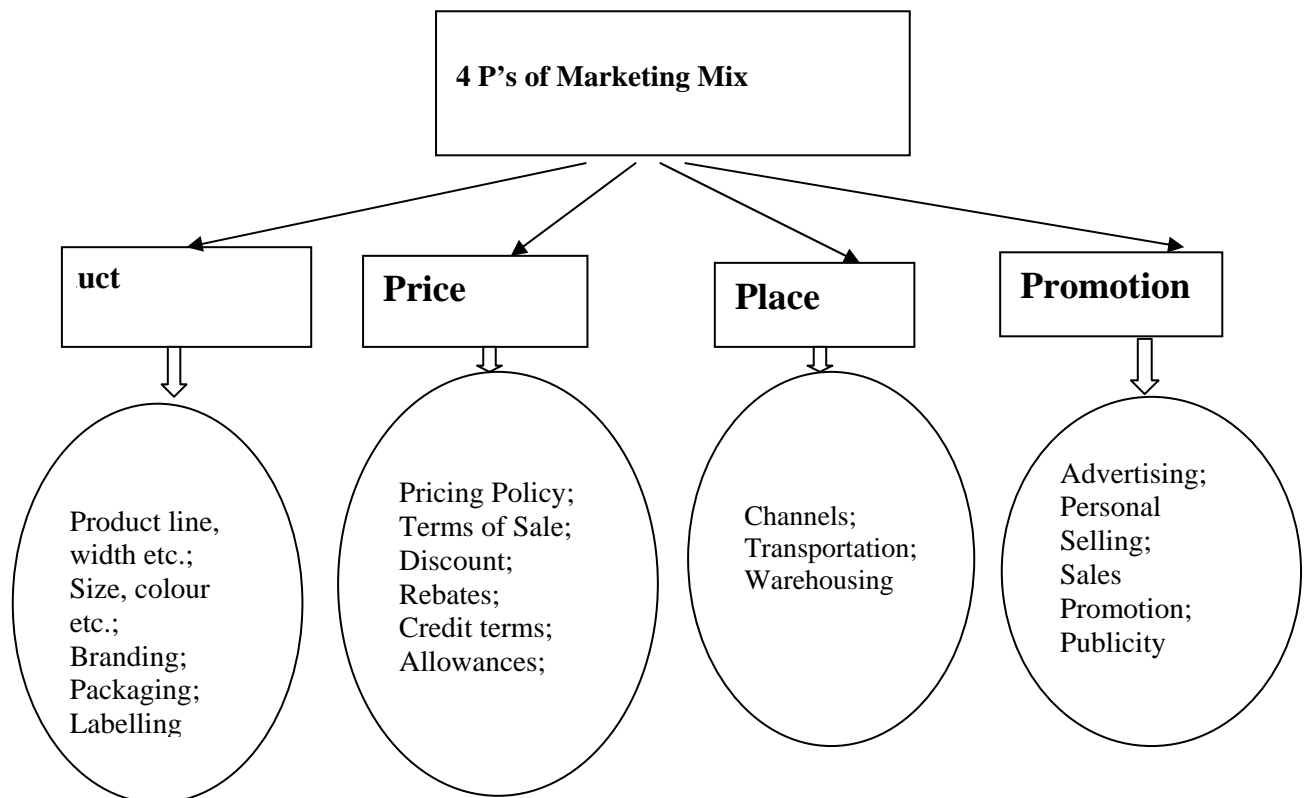


Figure 6.5: Chart showing 4 p's of marketing mix with their sub-elements

Let's explain the above-mentioned P's of marketing in the subsequent paragraphs.

Product mix refers to a combination of various features relating to the product or service to be offered for sale. It also refers to total number of products and items a businessman offers to the market. But, what is a product?

Product has a very special position in the marketing mix of a firm.

Product in the narrow sense: In this sense, the term ‘product’ denotes a physical commodity – a mere non-living object. The needs of the consumers are satisfied by using these products. These products can be designed as a need-satisfying entity e.g. a bottle of Kissan’s orange squash; a packet of Amul’s butter; a Cadbury chocolate bar etc.

Product in the wider sense: In this sense, a product is something more than a mere assemblage of matter. It takes into account the brand name, package etc. that go into the personality build up of the product. It is a source of providing material social and psychological benefits to the customers.

People derive satisfaction from the non-utility aspect of the product as well e.g. Kellogg flakes are consumed to satisfy hunger needs in the morning; but it is also used because of its brand name, packaging, prestige etc. A person feels that he has a better standard of living in consuming flakes manufactured by Kellogg’s than by a local company.

Do not all of us get attracted to buy potato wafers of ‘Uncle Chipps’ than purchasing any other local product? Therefore, it can be said that ‘product’ is the total package of benefits, which the customer receives when he buys it.

Sub-elements of product mix

Various sub-elements of product mix are discussed below:

I. The nature of product

The nature and characteristics of the product which are contained in the mix are related to:

- a) *Product Line:* It refers to a group of products within a product class e.g. in the case of Amul Co-operative Society, butter constitutes one product line, cream constitutes another, milk, a third one; and so on.
- b) *Product width:* The width of the product mix denotes the number of product lines that the businessman offers to the market. For example, Amul has a wider product mix whereas MDH has a narrow product mix.
- c) *Product length:* It refers to the number of product items that are carried in a product line. The length of product line denotes the number of items in the line e.g. Amul carries a number of product items in a butter line – it offers ‘white butter’ and ‘salted butter’. Similarly Amul cheese may be ‘cheese spread’, ‘sliced cheese’.

d) *Product Depth*: It refers to the total number of variants that are offered in each product item in the product line. In the case of Hindustan Lever Limited, the soap Lux may be Pink, white or Lux international.

II. Features of a product

The decisions regarding features of a product are mentioned below:

- *Size*: The size of the product should be easy to handle. It should be convenient to carry. For example, pack of Cadbury chocolate comes in manageable size.
- *Colour*: The colour of the product should be appealing. For example, the yellow colour of Brown & Polson custard.
- *Flavour*: The flavour of the product should have a wide variety of flavours: Priya Gold Biscuits are found in many flavours – pine-apple, elaichi, orange etc.
- *Weight*: A product should not be too heavy. For example Saffola oil comes in one litre pack, Amul butter comes in 100 gms. pack.
- *Durability*: A product should have a longer shelf life. For example Kissan tomato puree has a shelf life of 12 months.
- *Shape*: Solid products can be round (like Milk Bikis cream biscuits manufactured by Britannia); square (like Krack jack biscuits of Parle); rectangle (like Cadbury's Five Star chocolate) etc. In the case of liquid eatables they can take the shape of their containers. For example Pepsi, Coke, Kissan sauce, Kanodia Mustard oil etc.

III. Branding

A brand is a name, term, sign, symbol, or design or a combination of them, which is intended to identify the goods or services of the seller and to differentiate them from those of other competitors. A brand distinguishes a product from similar other offerings. A successful brand is a major asset for a company.

- *Brand Name*: It is that part of a brand which can be vocalized or uttered e.g. Five star chocolate, coca-cola, etc.
- *Brand Mark*: It is that part of a brand that can be recognised. It is not utterable since it is in the form of symbol; design etc. e.g. Nestlé's 'Nest' or Mother Dairy's 'Drop'.
- *Trade Mark*: When brand is given legal protection, it is called 'trade mark'. A trade-mark is a legal term protecting the seller's exclusive rights to use the brand name or brand mark. R in circle (i.e. ®) is used to show that the trademark is registered.

(To be scanned – Please refer Hard Copy)

Benefits of branding

- The customers find it easier to identify and handle the product.
- It gives the assurance of quality to the customers.
- Less time and energy is wasted in shopping because the customer has to just go to the market and name the brand. Thus, it makes shopping easier.
- A Purchase of a socially visible brand gives immense psychological satisfaction to the buyer.
- The quality of the product may also improve due to competition.

Selecting a brand name

Following aspects should be taken into account while selecting a brand name:

- It should reflect some benefit and functions of the product e.g. Good Knight, a mosquito repellent suggests that one can have a good sleep at night without mosquitoes.
- It should be distinctive. It should portray status, power etc e.g. Badshah Masale; Everest spices; Shakti-bhog Atta.
- It should be easy to pronounce and remember e.g. Taj Mahal Tea, Jagat Basmati rice.
- It should be legally protected.

IV. Packaging

Packaging may be defined as all the activities involved in designing and producing the containers or wrappers for a product.

Material used in packaging

- Wooden Boxes – Fruits
- Metal Containers – Processed food, oil
- Plastic – Rice, Ghee, Chocolate,
- Paper – Toffees
- Glass – Coke, Jam, Sauce
- Aluminium (foil) – Tea, Coffee

Setting up an Enterprise

- Jute Sacks – Rice, Wheat
- Tetra pack – Fruit juices, Fruit drinks
- Durable rubber tanks and drums (made from high tenacity polyamide plastic matrix) – Food grains, oil

Forms of package/container

- Tube – Fruit Jelly
- Bottle – Cold Drink
- Small unit package (200 gm, 50 gm) – Tea, Spices
- Sachets – Candy, soups, pan masala
- Re-usable containers (Jars) – Desi Ghee, Edible oil
- Refill packs – Coffee, Chocolate powder, Tea

Benefits of packaging

- It helps in keeping the product safe from pests, rodents, moisture, rain etc.
- It helps in storage.
- It helps in product differentiation.
- It helps in increasing sales.
- It increases the shelf life.
- It ensures visibility of the product if the packaging is transparent.

Activity

Match the following:

| Type of package | Product |
|-----------------|---------------------|
| 1. Tetra pack | A) Kissan Jam |
| 2. Glass | B) Frooti |
| 3. Plastic | C) Pineapple Slices |
| 4. Tin | D) Rice |

(Hint: 1. B; 2. A; 3. D; 4. C)

V. Labelling

The term labelling means putting labels on the package or the product. A label is a small slip to provide information to the customers e.g. the name of the product, price etc. A specimen of labelling is given below:



(Specimen of Labelling*)

Functions of labelling

Labelling serves the following functions:

- Identification of a product is easy for the customer.
- The manufacturer is able to grade the products into different categories, e.g. Hindustan Lever Limited (HLL) sells different types of tea under yellow, red and green label.
- It is a carrier of information.
- It provides information, which is mandatory by law.
- It attracts the buyers and draws them to buy the product.

6.5 MARKETING MIX – PRICE

Pricing is one of the most important decision-area of marketing. This is the only area from where revenue is earned by a businessman. Pricing is crucial to profit as well. Price is the exchange value of a product.

Factors influencing pricing policy

- *Consistency*: Pricing has to be consistent with overall objectives of the firm, e.g. the firm's objective may be profit maximization or to achieve a high turnover. Accordingly, it may be a higher price or lower price.
- *Public image*: If the public image of the product is high the price may be kept high.
- *Purchasing power of the consumers*: If the purchasing power of the consumers is low, the price should be kept low.
- *Price control measures*: The prices of certain products are controlled by the government. The businessman should fix the price keeping in mind the prevailing policies of the government.
- *Pricing policy of the competitors*: The businessman should fix the price keeping in view the pricing policy of the competitors.

* (The sample has been used for educational purpose only and not for any other use).

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- *Availability of substitutes:* The price may be kept higher in case there is no substitute available in the market.
- *Ability to postpone purchase:* If the consumer can think of postponing the purchase of a particular product the price of such product should be kept low.
- *Cost of production:* The price fixed should be such as would recover all the costs including a fair return to the businessman.
- *Demand and Supply:* If the demand of the product is higher than its supply the price may be fixed at a higher level. In case supply exceeds the demand, the price should be fixed at low level.
- *Current fashion and tastes:* If the product matches the current fashion and tastes, a high price may be fixed.

Decisions regarding terms of sale

The terms of sale, which the businessman may decide, shall include the following:

- Ex-works price
- Ex-warehouse price
- Cash sale price
- Credit sale price
- Instalment facility etc.

Decisions regarding discounts and rebates

The businessman, keeping in view the trends of business, may offer certain types of discounts and rebates. The may include:

- Trade discount
- Cash discount
- Off-season rebate
- Festival rebate
- Rebate for cash down purchase etc.

Activity

In the following Table two brand names of five products are given. Visit a local grocery shop; enquire about the MRPs of these products and on that basis fill the column relating to MRP.

| Product | Brand/Company | MRP | Brand/Company | MRP |
|---------------|---------------|-----|---------------|-----|
| 1. Jam | Tops | | Kissan | |
| 2. Milk | Mother dairy | | Parag | |
| 3. Edible Oil | Dhara | | Saffola Gold | |
| 4. Biscuits | Parle G | | Priya Gold | |
| 5. Bread | Britannia | | Harvest | |

6.6 MARKETING MIX – PROMOTION

Promotion of the product is another important element of marketing mix. Marketing depends heavily on effective communication flow between the business firm and the consumer. It involves informing the potential customers about the availability of product and stimulating them to buy it. The businessman usually chooses a combination of communication effects. This is called development of communication mix.

The following are the communication tools (or promotional measures), which a seller can follow:

- a) Advertising
- b) Sales promotion
- c) Personal selling
- d) Publicity

A combination of these techniques is used by the businessman depending upon the nature of the product, type of customers, degree of competition, etc.

a) Advertising

Advertising is a potent promotional tool of marketing communication. It is any paid form of non-personal presentation and promotion of ideas, goods or services by an identified sponsor. The businessman tries to spread his ideas about his product among his customers through advertising.

Benefits of advertising (for consumers)

- It provides information regarding price, availability, quality etc.
- Comparison with other products becomes easier.
- It acts as a guarantee regarding quality.

Benefits of advertising (for manufacturers)

- It increases the sale of the product.
- It helps in easy introduction of new product.
- It establishes contact between manufacturers and consumers.
- It helps build the image of a product.
- It enables them to face competition.

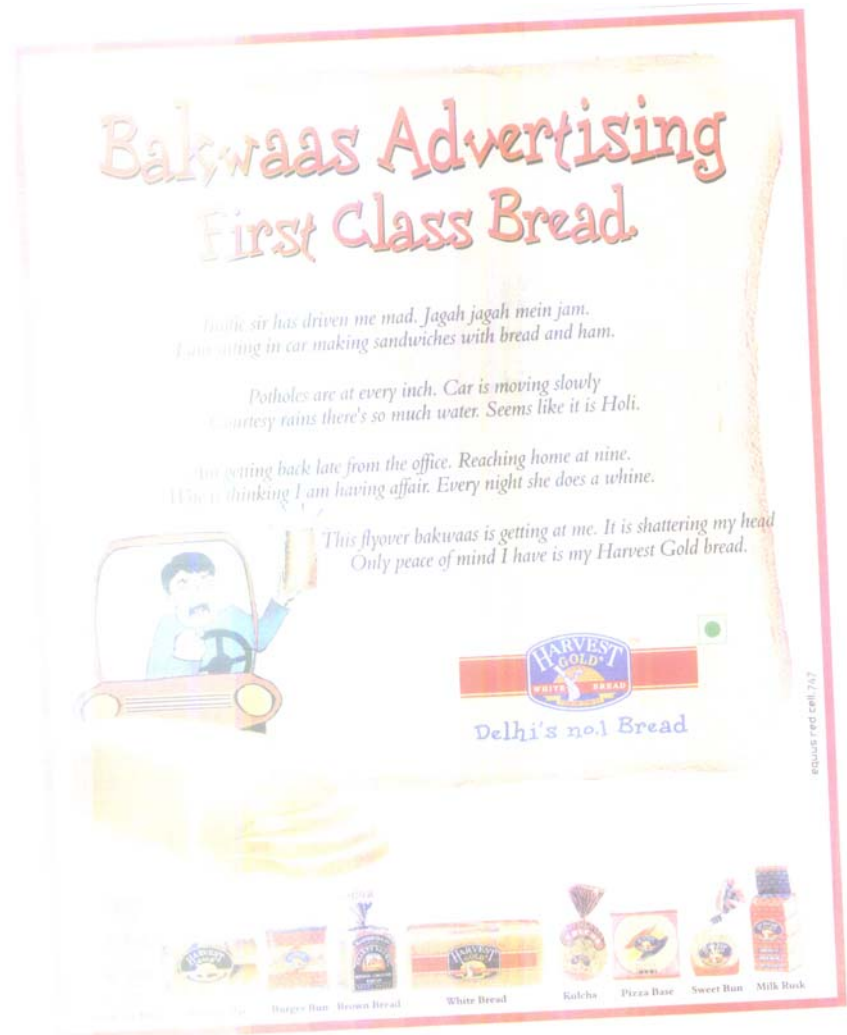
Media of advertising

The following Table shows the various kinds of media of advertising, which a manufacturer may resort to.

| Print media | Electronic media | Outdoor display | Direct mail |
|-------------|------------------|-----------------------|-------------|
| Newspapers | TV | Bill boards | Price list |
| Direct mail | Video | Hoardings | Catalogues |
| Folders | Radios | Balloons | Letters |
| Journals | Cinema | Electric poles | Circulars |
| Magazines | Internet | Fairs and exhibitions | Pamphlets |

Examples of good advertisements

1. Harvest Gold Bread
2. P mark Sarson Oil
3. Balrampur Chini



(Advertisement No.1*)

Do you know that only good quality mustard oil can offer you?

- High pungency with a rich flavour
- Natural anti-oxidants that prevent heart disease
- Cancer prevention properties

Choose the only Mustard Oil that gives you Three Dimensional Quality

70 Years of Trust and Reliability

Winner of National Award for Quality

The assurance of Govt. of India AGMARK Grade 1 Seal

HERE'S WHAT THE DOCTORS ARE SAYING...
Mustard oil is the ultimate edible oil for a healthy heart because of its high MUFA, low PUFA, low SFA, natural anti-oxidants and an ideal ratio of omega 3 & 6. It also helps prevent Hypertension, Diabetes and Breast Cancer."
Dr. Narinder Saini
Eminent Cardiologist, Springfield, Ohio, USA.

Quality and Purity trusted for over 70 years

ISO 9001 CERTIFIED



(Advertisement No.2*)

Activity

Scan your environment and write the method of advertising used by the following companies to advertise their products:

* (The sample has been used for educational purpose only and not for any other use).

| Company/Brand | Media |
|-----------------------|-------|
| 1. Horlicks | |
| 2. Pepsi | |
| 3. Badshah Masala | |
| 4. Heinz Tomato Sauce | |

b) Sales promotion

Sales promotion is an effort to stimulate consumers to purchase more and more of a particular commodity. It draws quick response from the target audience. It serves as a short-term incentive.

Various means of sales promotion (At consumer level)

Following are the various means of sales promotion at consumer level:

- Distribution of free samples
- Organisation of various contests
- Offer of refund of money if the product is not up to the satisfaction
- Offer of free gifts along with the product
- Offer of discounts and rebates
- Offer of quantity deals like 'buy two get one free'
- Demonstration
- Instalment payment

c) Personal selling

It is the oldest method of selling a product. It means selling personally. It is oral, face-to-face interaction between a seller and prospective customers for the purpose of making sales. It leads to 'on the spot sales'.

The salesman usually goes door to door, presents and demonstrates the product and tries to negotiate a deal. He also acts as a guide as he informs about the product.

A well-trained and competent salesman can be an effective communication instrument. His knowledge about the product, the company, its future plans, familiarity with customers, level of his motivation will be the determining factors in his role as a communicator.

d) Publicity

Publicity is not easily controllable by the firm. It is not paid for by an identified sponsor. Large firms normally try to control, through constant press releases, press conferences etc. Such activities are intended to build a favourable and positive public image of the firm but an adverse message

appearing in some media about a product may spoil the image of the company.

6.7 MARKETING MIX – PLACE (DISTRIBUTION)

Place mix involves decisions to be taken in order to make the product available to the customers. Two decisions are required to be taken for this purpose:

1) *Development of channels of distribution*

Channels of distribution refer to the path taken by the goods in their movement to the customers. It starts with the producer and ends with the consumer. In between there may be a network of inter-dependent organisations or people employed like agents, dealers, wholesalers and retailers, which help in the transfer of product.

2) *Physical distribution of product*

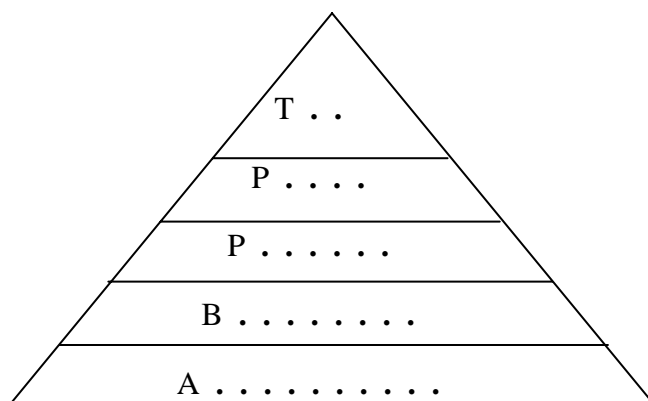
Physical distribution involves physical handling of movements of goods from place of production to the place of consumption. Physical distribution fills time (through warehousing) and place (through transportation) gap by providing goods at right place, at right time in the right condition and lowest possible cost.

Check Your Progress Exercise 2



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

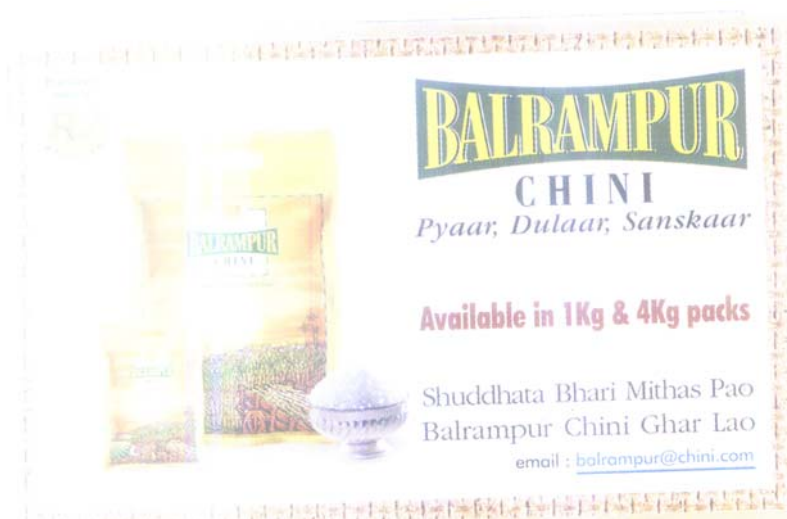
1. On the basis of the given clues fill the following pyramid:



Clues:

- i) A package material (3 letters)
- ii) Exchange value of a product (5 letters)
- iii) A carrier of physical and psychological satisfaction (7 letters)
- iv) Assigning name to a product (8 letters)
- v) A paid form of non-personal presentation and

2. List the 4 P's of marketing mix.
 - i)
 - ii)
 - iii)
 - iv)
3. You are a manufacturer of Bikaneri Namkeen. You want to appoint a salesman for door-to-door selling of the product. Name two qualities, which he should possess in order to be a good salesman.
 - i)
 - ii)
4. Name the oldest method of selling products.
.....
.....
5. Name the non-paid form of communication tool.
.....
.....
6. Observe critically the following advertisement and comment on the basis of information provided in the advertisement whether:
 - i) it is attractive to you as a prospective consumer.
 - ii) it contains complete information about the product.





6.8 LET US SUM UP

Marketing is the central function of any business. The entire business is a customer satisfying process. Marketing enables a businessman to sell his goods to the consumers. The functions of marketing may be broadly categorised as functions of exchange; functions of physical supply; and facilitating functions. The functions of exchange involve activities associated with buying; assembling and selling. The functions of physical supply include transportation; storage (also called warehousing); inventory management; and order processing. Facilitating functions refer to the activities involved in helping the process of exchange. Important facilitating functions include marketing research, standardisation and grading, financing and risk taking. Marketing mix is a plan designed to analyse the marketing problems. The four areas of marketing mix, known as 4 P's, are product mix, price, place (distribution) and promotion. Product mix involves decisions involving product line, product width, product size, its colour, branding, packaging, labelling etc. In the case of price mix the businessman takes decisions relating to pricing policy, terms of sale, discount, rebates, credit terms, allowances etc. Decisions regarding channels of distribution, transportation, warehousing etc. are related to place mix and finally promotion mix involves decisions regarding advertising, personal selling, sales promotion, publicity etc.

6.9 KEY WORDS

| | | |
|-----------------------------------|---|--|
| Ex-works price | : | Factory price. |
| Inventory | : | Stock of goods |
| MRP | : | Maximum retail price. |
| Price elasticity of demand | : | Ratio of the percentage change in demand caused by a percentage change in price. |
| Trade discount | : | Discount allowed by a trader when goods are purchased in bulk quantity. |
| Warehouse | : | A place where goods are stored. |

6.10 ANSWERS TO CHECK YOUR PROGRESS EXERCISES



Check Your Progress Exercise 1

1. i) Buying ii) Transportation iii) Facilitation

* (The sample has been used for educational purpose only and not for any other use).

- iv) Warehouse v) Risks
2. 1) B 2) A 3) D 4) C 5) E
3. i) Rice and wheat;
ii) For purchase of raw material; payment of salary;
iii) Consumers and Dealers;
iv) Questionnaires; E-mails;
v) Trucks; Bullock Carts.
4. **Hint:** i) Storage of goods;
ii) Bulk purchase or manufacture of goods;
iii) Adjustment of supply with demand.
5. **Product:**
i) Reviewing product line, product quality, Product features etc;
ii) Testing of new products.
- Consumers:**
i) Study of the consumer tastes;
ii) Study of consumer dissatisfactions.

Check Your Progress Exercise 2

1. i) Tin
ii) Price
iii) Product
iv) Branding
v) Advertising
2. i) Price ii) Product
iii) Promotion iv) Place
3. i) Understanding about the product.
ii) Motivation to do hard work.
4. Personal selling.
5. Publicity.
6. **Hint:** Look at the advertisement critically and answer accordingly.

6.11 SOME USEFUL BOOKS

1. Bhushan, Y.K. (2005) Fundamentals of Business Organisation and Management; Sultan Chand and Sons, New Delhi.
2. Kotler, Philip (2004) Marketing Management – Analysis, Planning and Control, Prentice Hall of India, New Delhi.
3. Varshney, R.L. and Gupta, S.L. (2000) Marketing Management (An Indian Perspective); Sultan Chand and Sons, New Delhi.

6.12 ASSIGNMENTS

1. “It pays to advertise” Justify.
2. Explain how a businessman can promote his sales.
3. “Victoria Foods” have diversified and started processing and packing ‘light oven baked porridge (Dalia)’. You are the marketing manager of this firm. What factors will you keep in mind to decide the price of this product?
4. “Bhojan India” wants to transport 50 cartons of ‘White wheat Flour’ from Chandigarh to Delhi. Which means of transport should they use and why?
5. ‘A warehouse serves the function of protecting goods’. Do you agree? Give reasons in support of your answer.
6. What should a businessman do after receiving orders from a customer?
7. How is marketing research done?
8. What are the features of a good brand?
9. Name the material, which a businessman may decide to use for packaging the following products:
 - a) Apples
 - b) Mango juice
 - c) Roasted chana
 - d) Mustard oil
 - e) Cookies
10. “A good package acts like a silent salesman”. Justify this statement on the basis of following specimen of a package.

Setting up an Enterprise



(Advertisement No.4*)

UNIT 7 ANALYSING THE COMPETITIVE SITUATION

Structure

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Competitors Present in the Market
- 7.3 Marketing Strategies vis-à-vis Competitors
- 7.4 How to Understand the Strengths and Weaknesses of Business
- 7.5 What are the Strengths and Weaknesses of the Competitors
- 7.6 Special Features of the Product to Attract Customers
- 7.7 Let Us Sum Up
- 7.8 Key Words
- 7.9 Answers to Check Your Progress Exercises
- 7.10 Some Useful Books
- 7.11 Assignments

7.0 OBJECTIVES

After studying this unit, you should be able to:

- get a clear view of the competitors who are posing competition in the market;
- comprehend the strengths and weaknesses of the competitors;
- understand the market strategies a businessman is required to develop;
- know about the SWOT expand analysis; and
- understand the special features of the product which makes it attractive.

7.1 INTRODUCTION

You will note that in today's world, every individual is running a race to achieve a certain goal. All of us are in a hurry – either in search of a goal or to reach a goal before anybody else reaches there. In this process, every one has a desire to excel and be at the top. In this era of technological advances and higher levels of mass communication, followers have no place. Respect, prestige and power are only with the leader.

The child who is awarded the prize is the one who gets first rank in the class. The students who get admissions in prestigious colleges are those who find place in the merit list. The same is the case with a businessman too. They are also busy running a race. Some may have won and reached the top whereas there are others who are trying to reach the coveted place. But, what is that coveted place, the destination. It is the hearts of their customers.



(*Competition: Racing for No. 1 Position to become Market Leader*)

It is only when a businessman satisfies his customers and makes them happy and loyal he will slowly and gradually achieve the maximum share of his target market. And the day may come when he will be Rank 1 holder, being adjudged as “market leader”.

But, do you think, in this process of capturing the market share, other followers (i.e. Rank 2, Rank 3, Rank 4 and so on) will keep quiet? No! They will not sit back and see another capturing the market. They will think of various strategies to beat the Rank 1 who has been adjudged as “market leader”. But the game will not stop at this stage. Now, the Rank 1 will make his counter moves to retain his position in the market. Thus there will be moves and counter moves and the players in the market (i.e. various businessmen) will always think of new strategies to defend themselves or confront competition.

7.2 COMPETITORS PRESENT IN THE MARKET

Every industry – whether it is automobiles, textiles, iron and steel, pharmaceuticals, chemicals, or food processing industry – is composed of many firms dealing in the same product. Usually competition prevails within one industry and each firm has to face stiff competition from the others. They compete with each other to gain the top slot, by achieving maximum share of the market as:

1. Market leader

A market leader is the one, who has reached the place where others want to reach. In a way he has gained maximum share in the relevant product market. It leads the other firms in price changes, new product introduction, distribution coverage etc. For example, there are 4 firms in a particular industry with the following market share:

| | |
|--------|-----|
| Firm A | 60% |
| Firm B | 25% |
| Firm C | 10% |
| Firm D | 5% |

Here, Firm A is the market leader with 60% share in the market.

For other businessmen, the market leader acts as a competitor because his strategies and moves will have a direct impact on the turnover and profits of the other firms. Though competition will not be very severe because it will be quite difficult for other firms to confront and attack the market leader by taking advantage of his weakness, if any.

2. Market challenger

The firm that occupies a place next to the market leader in an industry is known as market challenger or runner-up. There may be one such market challenger or more than one. These firms are also very large but smaller than market leader.

Market challengers are a threat to both the market leader and the other competitors. They would try to grab further market share by directly attacking the leader or by attacking other competitors, if not the market leader. For example, there are 4 firms in a particular industry with the following market share:

| | |
|--------|-----|
| Firm A | 40% |
| Firm B | 35% |
| Firm C | 15% |
| Firm D | 10% |

In the above case Firm B is the market challenger. It can easily become a market leader by grabbing only five or six percent of the share from the market followers or 3% from the leader. Market challenger tries to discover the weaknesses of small firms and of the market leader and then builds up its own strategy.

3. Market followers

Market followers are usually small sized firms. They have lower market share than the leader and the challenger. They are actively trying to expand their share through highly aggressive tactics. All the firms who fall in this category act as rivals to one another. They face a threat from the market challenger who is always keen to gobble up some of their share. They have somehow to hold on to their current customers. All the firms coming in this category occupy almost similar position in the market. They may also have similar resources and similar output. For example, there are 4 firms in a particular industry with the following market share:

| | |
|--------|-----|
| Firm A | 40% |
| Firm B | 35% |
| Firm C | 15% |
| Firm D | 10% |

In the above case Firms C and D are the market followers. Both the firms are acting as rivals to one another to retain the existing share. Both have a threat from the side of market challenger i.e. Firm B who is always keen to gobble up part of their share to become market leader. Even market leader may also try to gobble up party some more of the market to make its position more secure against the market challenger.

4. New entrants

A new entrant is one who has just stepped into that industry. This business unit acts as a source of direct competition to the firms which are already in the business. The new entrant can be a resourceful business unit which has entered a new industry because of its expansion and diversification policies. This new entrant may be a leader in his own field.

5. Very small firms

These firms are very small in size. They cannot attack the larger firms. They earn profits from customers, geographic area, or service.

6. Powerful suppliers

When the businessman acts as buyer in the market he must understand the market power of the different suppliers. There may be powerful suppliers in the market. They are so large and powerful that they are in a position to dictate the price and the terms of supply. The power of the suppliers is high when there are very few suppliers in the market. And therefore the businessman has limited option for source of supplies. He will compete with other similar purchasers and will have to put efforts to acquire the supplies at a reasonable price and as per his requirements – quality, time, and quantity etc.

7. Powerful buyers

Similar to powerful suppliers there may be powerful buyers in the market if it is a ‘buyers market’. Since these buyers are big and powerful they will dictate their prices, terms of purchase, their preferences for packaging, product quality, and delivery terms.

8. Substitute products made available by other competitors

The product supplied by the businessman is to be considered in the light of uniqueness. He has to see whether his product is unique or there exists any substitute for the same. It may also happen that at a later stage a substitute may arise. In case the substitute is or arises later the businessman will have to see how he is to protect his market and customers.



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Who is market leader?

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.....

2. Which kind of competitor is usually called a runner-up?

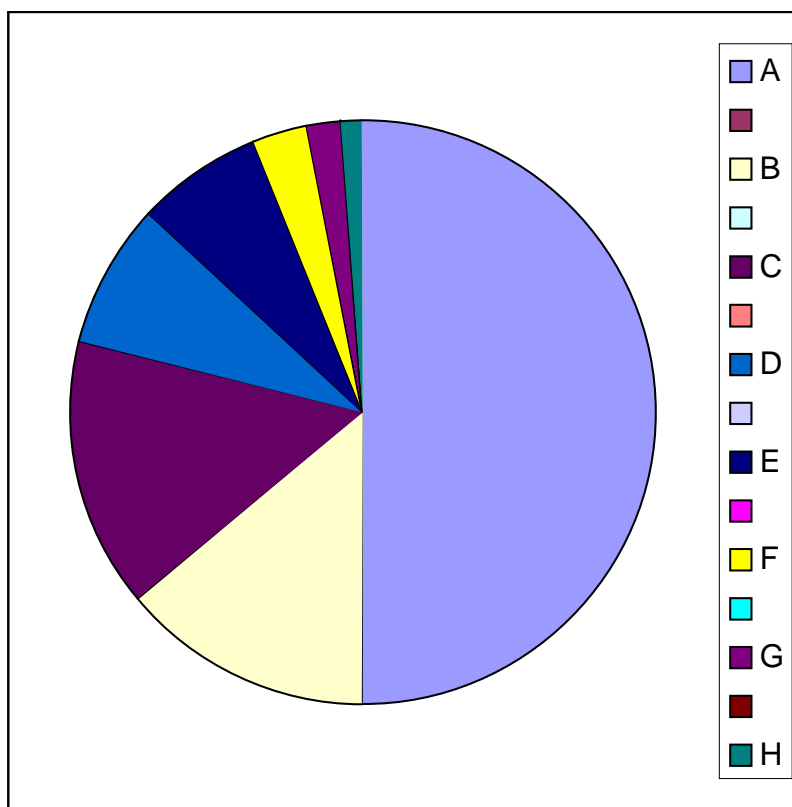
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3. Following is the hypothetical market share of the various firms:

- A) 50%; B) 14%; C) 15%; D) 8%;
E) 7%; F) 3%; G) 2%; H) 1%

Fill in the blanks after analysing the following pie diagram which depicts the market share of above firms:



- i) ----- is the market leader.
ii) ----- are the market challengers.
iii) ----- are the market followers.
iv) ----- are the small firms.

7.3 MARKETING STRATEGIES VIS-À-VIS COMPETITORS

The businessman has to develop his marketing strategies on the basis of the activities of his competitors. Following are the areas/activities in which the businessman can develop his marketing strategies:

- i) *Innovations*

To beat the competitors the businessman can decide to launch a new product. He can also think of innovative ideas related to customer service, means of distribution etc.

ii) Prices

The businessman can keep the prices of his products reasonable in comparison to the price structure maintained by his competitors. At times, the businessman may reduce the prices as well. However, a fear of price war is always associated with this kind of strategy.

iii) Promotional strategies

The businessman can adopt promotional strategies by offering discounts, organizing contests, providing free gifts etc. to the customers. But this will also mean sizeable promotional expenditure.

iv) Quality strategies

Continuous efforts can be made to improve the quality of the product. At times, we find a slogan 'New and Improved' printed on the package of the product. This is nothing but to beat the competitor that firm's product is now improved as compared to that of the competitor. The firms, now-a-days spend a lot on research and development (R & D) activities. The expenditure is incurred with a view to improving the quality of the product.

v) Product size

The businessman can make additions in the size and form of his product. In other words he can bring a product in several sizes and forms, which his competitors may not be having. For example, a ketchup manufacturer may plan to bring his product in many innovation or quality and bottle sizes.

vi) New brand

A businessman may launch a new brand of the same product. Each of the brands can be positioned differently in the minds of the consumers.

vii) Heavy advertisement

The businessman can undertake heavy advertisement campaign. This will help him to create strong consumer awareness and preferences.

viii) Competent sales force

Manpower is an asset for any firm. A good and confident sales force maintained by a businessman may fetch him reputation, good business, loyalty of the customers etc.

ix) Manufacturing efficiency

This is another way of facing the competitor. The businessman tries to keep the cost of production low by efficient purchase of material, low labour cost, using modern equipments, etc.

x) Efficient and extensive dealership system

A large number of independent dealers can be maintained in the industry. The dealers can be located all over the country and even outside the country also, if the demand arises. An exclusive dealer may focus all of their attention on his product.

xi) Credit policy

In order to increase his turnover in comparison to his competitors the businessman may offer his product on credit terms – instalments, repayment period etc.

xii) Better after-sales services

The businessman may offer better and efficient after-sales service to his customers. A satisfied customer will not only be loyal to him but may bring in more customers through his contacts. Thus, the businessman may expect that the potential customers will not go to his competitors.

Check Your Progress Exercise 2



- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. What can be the marketing strategy of a businessman in respect to the size of the product?

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2. Mention any four ways by which a businessman can counter-act the activities of his competitors.

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7.4 HOW TO UNDERSTAND THE STRENGTHS AND WEAKNESSES OF BUSINESS

Several functions are carried out in a business enterprise. These are linked with production, research and development, personnel, finance, marketing, etc. The businessman can understand his strength by splitting each function into sub factors. Through this exercise specific factors are identified. Then he tries to

zero in on the specific factors, which he can point out and say “Hey, this is my strength”.

Business firms have to spot their competitive strengths and nurture them. By studying the competitive strength with respect to the firm’s overall strength or weakness in the given area, the firm has to find out – what its distinctive advantages are. For this purpose, internal scanning is to be done. It may relate to –

- Which are the functions the firm does well compared with his competitors.
- Does the firm really excel in them?
- Which are the functions where the firm is weak?
- To what extent does the weakness matter in overall performance?
- Can the weaknesses be made up?

To have a better understanding, the business firm should conduct SWOT Analysis.

SWOT analysis

Just as a doctor needs thermometer or a stethoscope to diagnose an illness, in the same way a businessman needs to do a SWOT analysis to assess the competition he faces in the market. SWOT analysis is an analysis of:

- S : Strengths
- W : Weaknesses
- O : Opportunities
- T : Threats

It is a process through which the strengths, weaknesses etc. of a competitor can be assessed. In fact SWOT analysis can be used for any purpose i.e. to evaluate a project; any market opportunity etc.

Strengths: Strengths refers to the strong points a businessman possesses. His strength may lie in the quality of his product or his strategic location or his huge capital base and so on. He should have a firm faith in his internal resources and he should utilise them to their fullest capacity. His strength in a particular area may be the weakness of his competitor.

Weaknesses: The businessman should also always recognise his weak points. He should endeavour to convert his weaknesses into strengths. The weaknesses can be rectified only when they are identified.

Opportunities: There is no dearth of opportunities. The businessman should keep his mind open and make a list of various opportunities, which may be available for him to explore.

Threats: The businessman should be aware of the threats he faces as well. His competitors in the market always pose a threat to him. They may try to divert his customers by offering better product. He should keep on trying to convert the possible threats into opportunities.

In the following way a businessman who is dealing in manufacturing of mango-chutney may conduct SWOT analysis:

| | |
|--|--|
| <p style="text-align: center;">S</p> <ol style="list-style-type: none"> 1. Mango chutney goes well with almost every Indian food. 2. Low Investment required for manufacturing chutney. | <p style="text-align: center;">O</p> <ol style="list-style-type: none"> 1. Wide spread market can be captured. 2. Different varieties of chutneys can be introduced. |
| <p style="text-align: center;">W</p> <ol style="list-style-type: none"> 1. Seasonality of raw material. 2. Seasonality and availability of labour. | <p style="text-align: center;">T</p> <ol style="list-style-type: none"> 1. Presence of a large number of competitors in the market. 2. Tastes of the customers may get changed. |

Keeping the points mentioned in the above box (and many more which can be perceived) the businessman has to make continuous efforts to convert his weaknesses into strengths and threats into opportunities to the maximum extent. This way he can thwart competition.

Check Your Progress Exercise 3



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Write the full form of SWOT.

.....

2. How can a business man conduct SWOT analysis?

.....

7.5 WHAT ARE THE STRENGTHS AND WEAKNESSES OF THE COMPETITORS

Just as an individual has certain strengths and weaknesses, in the same way a business firm possesses certain qualities, which are its strengths and also a few points which are its weaknesses. Big firms generally take the benefit of their size and small firms have the benefit of flexibility and speed of functioning.

The strength of the competitors can emerge in any of the many functions they perform. These functions may be associated with marketing, production, research and development, corporate resources. In the following paragraphs an

attempts made to discuss these factors. The presence of these factors may act as strength whereas the absence of these factors may mean weakness.

Product mix

To gain an edge over others, the competitor can shape his product strategy around the technical superiority of his product. The product can be a special product supported by the best technology and its superior quality. He may also be providing attention to quality control and quality assurance. The competitor can be stronger if he has a wide product line. He may also provide maximum possible variety in every product line.

The competitor may also be keeping in mind the tastes and preferences of the customers based on demographic, geographic and psychological factors.

Packaging

The packaging of a product may also serve as a potent strength in the competition. Good packaging adds to the value of the product. An attractive package may lead to increase in turnover. A package contains lot of information as well. It acts as a silent salesman. A good package, therefore, if developed by a competitor may act as a strong point. A new package design, colour, size of the package, material used etc. can all serve as strengths.

Distribution

Some competitors may have a distinctive competence in distribution. They may have a distribution network reaching the remotest rural areas of the country. They may also have a vast chain of showrooms in all metropolitan cities and other big cities of the country. They may have a computerized physical distribution method as well. The other advantage, which the competitors may have, is to have a chain of big stockists who get the supplies directly from the producers. They may also adopt progressive distribution policy, attractive incentives and best margins for dealers.

Service

Providing efficient service to the customers would also be a strength. For example, M/s. A.B. & Co. may assure its customers to provide after-sales service within 24 hours of the receipt of call.

Personnel

A pool of highly talented engineers, technicians and managers and other personnel would be highly motivated and dedicated because of handsome salaries and other perquisites.

Production

A competitor's strength may lie in the production function. He may come out with large quantity of production within a very short period of time. For example, M/s. Ruchika & Co. may have a high capacity of manufacturing biscuits and other bakery items. Expertise in production planning and scheduling will provide an edge over other businessmen particularly if it matches with the market requirements.

Research and development

This is another area where a competitor may have an edge over the other businessmen. A competitor may possess a competence for making unique products. He may have strong in-house R&D facilities for consistent product augmentation and improvement.

Corporate and finance factor

A competitor may have a reputation in the market. Owing to the goodwill built by him, he is in a position to raise large equity in the capital market. A competitor's strength may also lie in the huge reserves built by his firm. With the help of these reserves he will not face resource crunch when there is depression in the market and it becomes difficult to obtain funds from external sources.

Marketing

A competitor may be well-versed with marketing techniques. His sales forecasting may be very accurate or he may be possessing a highly computerized and high quality Management Information System (MIS). A competitor may be in a position to incur heavy expenditure on advertisement and publicity as well. The price strategy followed by the competitor may be such that it attracts abundance of business.

Check Your Progress Exercise 4



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. How can an attractive package lead to increase in turnover of a competitor?

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2. "A competitor's strength lies in his production function." Justify.

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7.6 SPECIAL FEATURES OF THE PRODUCT TO ATTRACT CUSTOMERS

Quality of the product is one major factor on which a businessman can count.

Features of the product

i) *Value for money*

A businessman should develop his product in such a manner that the customer utilizing it should get value for the money spent by him in purchasing the product. For example, if a customer purchases Britannia Cake, it should give him the value, which he thought he will get if he had spent the same money on some other product.

ii) *Tangible attributes*

- *Size:* The product should be of such size that it can easily be handled.
- *Colour:* The product should be of attractive colour so that it appeals to the customer at the first look.
- *Weight:* A product should not be too heavy to lift. It may be packed in such a way that the customer is in a position to carry it easily. Usually oils are packed in one Kg./one litre packs.
- *Durability:* Most of the products are not meant for one time use. A customer will prefer a product, which can be used for a reasonable period. In other words the product should contain proper preservatives.
- *Packaging:* The product should be packed in such a manner that it remains safe from pests, moisture, rain etc. A good packaging should help in increasing sales and the packed product can be stored easily.
- *Shape:* The shape of the product should be appealing. It may be round, square, rectangle or any other shape. Liquids will of course eatables they can take the shape of their containers.
- *Branding:* The brand name of the product should be such that the customers will find it easier to pronounce and remember. The customer should easily identify the product with its brand name. It should give the customers the assurance of quality.

iii) *Augmented attributes*

Some additional features can also be added to the product, like:

- Providing after-sales service;
- Providing various finance options like purchasing goods on instalment basis, purchasing goods on zero interest rate etc.
- Providing delivery arrangement like free home delivery;
- Offering warranties.

iv) *Product variety*

The businessman should try to offer a number of variants in the product. For example a product can come in various flavours.



Check Your Progress Exercise 5

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. List any four tangible attributes of a product.

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.....
.....
.....

2. Mahesh is a businessman who manufactures mango pickles. Mention any two quality features which he should try to bring in his product so as to make it preferable to those of his competitors.

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.....
.....

7.7 LET US SUM UP



Every individual, be it a businessman or any other person is running a race to achieve the No. 1 position. In case of a businessman, however, it is only when he satisfies his customers and makes them happy and loyal he will slowly and gradually achieve the maximum share of his target market. Market comprises a number of competitors. There may be market leader, market challengers, market followers, new entrants, small firms etc. Powerful buyers, powerful suppliers and substitute products are capable of posing competition. As regards marketing strategies to be adopted by a businessman, they are to be adopted based on the activities of the competitors. To understand the strengths and weaknesses of the business, the businessman is required to carry out SWOT Analysis. He has to try his level best to convert weaknesses into strengths and threats into opportunities. A competitor will pose competition to the businessmen due to the presence of certain strengths. The strength of the competitors lies in the level of their functions (like marketing, production, research and development, corporate resources). To thwart competitors, a businessman has to provide quality products to his customers. There are so many features associated with any product that he has to provide a product which gives value to the purchaser for the money spent in purchasing it. The product should have certain tangible attributes. The businessman may also add a few additional features to the product to make it more attractive than that of his competitors.

7.8 KEY WORDS

- Market leader** : A business firm possessing largest market share.
- Market challenger** : A business firm posing threat to the market leader.
- Tangible attributes** : Features of a product perceptible to the senses – sight, smell and mostly taste.

7.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES



Check Your Progress Exercise 1

1. **Hint:** Market leader is the organisation which has gained maximum share in the relevant product market.
2. **Hint:** The firm that occupies a place next to the market leader in an industry is known as runner-up.

3. i) *Firm A* is the market leader.
- ii) *Firms B and C* are the market challengers.
- iii) *Firms D and E* are the market followers.
- iv) *Firms F, G and H* are the small firms.

Check Your Progress Exercise 2

1. **Hint:** The businessman can make additions in the size and form of his product.
2. **Hint:** Innovations; Price; Product size; New Brand

Check Your Progress Exercise 3

1. Strength, Weakness, Opportunity, Threat
2. **Hint:** By analysing his Strength, Weakness, Opportunity, and Threat.

Check Your Progress Exercise 4

1. **Hint:** Good packaging adds to the value of the product and thereby an attractive package may lead to increase in turnover of a competitor.
2. **Hint:** A competitor may come out with large quantity of production within a very short period of time.

Check Your Progress Exercise 5

1. Size; Colour; Durability; Branding
2. i) Increased durability of the product.
ii) Attractive packing.

7.10 SOME USEFUL BOOKS

1. David H. Holt (2002) *Entrepreneurship – A New Venture Creation*, Prentice Hall of India Private Limited, New Delhi.
2. Ramaswamy, V.S. and Namakumari, S. (1998) *Marketing Management (Planning, Implementation and Control – The Indian Context)*, Reprint, Macmillan India Limited, Delhi.
3. Varshney, R.L. and Gupta, S.L. (2000) *Marketing Management (An Indian Perspective)*, Sultan Chand and Sons, New Delhi.

7.11 ASSIGNMENTS

1. Mention any five points relating to the strengths and weaknesses of the competitors.
2. Read the following situation:
 - i) Firm I deals in fertilizers.
 - ii) Firm G deals in textiles.
 - iii) Firm N deals in cosmetics
 - iv) Firm O deals in agro-based products
 - v) Firm U is a new entrant desiring to manufacture mushroom soup.

Based on the above, identify the competitor for Firm U. Give reasons in support of your answer.

(Hint: Firm O)

3. Radha Food Limited manufactures ‘ready-to-eat’ products. They want to conduct SWOT Analysis in order to guard against the various competitors some of whom are new entrants. They have appointed you as a new market researcher. On the basis of following jumbled up points you are required to group them in the given Table:
 - i) 14 year old established company.
 - ii) Low average perception among consumers.
 - iii) Entry of MNCs on a large scale.
 - iv) High competition.
 - v) Both husband and wife form a working couple.
 - vi) Status symbol.
 - vii) Use of latest technology by the company.
 - viii) Low product range.
 - ix) Huge Capital and dedicated staff.

| | |
|---|---|
| <p style="text-align: center;">S</p> <p>1.</p> <p>2.</p> <p>3.</p> | <p style="text-align: center;">O</p> <p>1.</p> <p>2.</p> <p>3.</p> |
| <p style="text-align: center;">W</p> <p>1.</p> <p>2.</p> <p>3.</p> | <p style="text-align: center;">T</p> <p>1.</p> <p>2.</p> <p>3.</p> |

(Hint: i) S; ii) W; iii) T; iv) T; v) O;
 vi) O; vii) S; viii) W; ix) S)

4. Explain the roles of market leader and market challenger in a competitive market.
5. “The strengths of the competitors emerge from the functions they perform” Do you agree? Give reasons.
6. To what matters would “internal scanning” relate?
7. Following is the hypothetical market share of various firms operating in a particular industry:

| | |
|--------|-----|
| Firm A | 48% |
| Firm B | 42% |
| Firm C | 5% |
| Firm D | 5% |

**Setting up an
Enterprise**

You are required to answer the following questions:

- i) Can Firm D act as a threat to Firm B?
- ii) Can Firm B act as a threat to Firm A?
- iii) Can Firm B act as a threat to Firm C?
- iv) Can Firm C act as a threat to Firm A?
- v) Can Firm D act as a threat to Firm C?
- vi) Can Firm C act as a threat to Firm D?

(Hint: i) No; ii) Yes; iii) Yes; iv) No; v) Yes; vi) Yes)

UNIT 10 UNDERSTANDING THE COMPONENTS FOR MARKETING MIX

Structure

- 10.0 Objectives
- 10.1 Introduction
- 10.2 Meaning of Marketing Mix
- 10.3 Marketing Mix – Product
- 10.4 Marketing Mix – Price
- 10.5 Marketing Mix – Promotion
- 10.6 Marketing Mix – Place
- 10.7 Let Us Sum Up
- 10.8 Key Words
- 10.9 Answers to Check Your Progress Exercises
- 10.10 Some Useful Books
- 10.11 Assignments

10.0 OBJECTIVES

After studying this unit, you should be able to:

- know about the meaning of marketing mix;
- understand the importance of marketing mix;
- identify various elements of product mix;
- comprehend the pricing of the product;
- understand the various aspects of promotion; and
- know the physical distribution of goods.

10.1 INTRODUCTION

Human needs are unlimited. Human beings need different types of commodities to satisfy their needs. A businessman therefore, engages himself in manufacturing different types of products and services. Marketing can be said to be a process involved in the exchange of goods and services for payment of their cost.

Marketing refers to all those activities which help in directing the flow of goods from the manufacturer to the ultimate user. In other words, the process of marketing leads to the exchange of goods and services through which the needs of the consumers are met.

A businessman has to undergo various activities and to decide upon various issues in order to reach his target. For this purpose, the firm must develop the product, determine its price, inform the potential customers about the product, and make it available to the present and potential customers. All these activities signify that the businessman has to put together all the tools at his disposal in combination so that his objective of selling the goods and services with profitable margins is realised. In the light of this view, a businessman can be thought of as an assembler or mixer of ingredients. The success of the businessman depends on how well these ingredients are assembled.

Marketing mix is nothing but the ingredients or the tools or the variables that the businessman mixes in order to interact with a particular market. Marketing mix has been discussed briefly in Block 2 (Unit 3) – “What does Market Involve”, keeping in view the requirements of that Unit. In this Unit, marketing mix has been taken up in detail.

10.2 MEANING OF MARKETING MIX

Meaning and Importance

Marketing mix is a term which is usually used to refer to a particular combination of marketing variables which are controllable by an enterprise. Marketing mix can be regarded as the core of any business firms marketing system. According to Philip Kotler “Marketing mix is the set of controllable variables that the firm can use to influence the buyers’ response”. In simple words, marketing mix can be said to be the set of marketing tools that the firm uses to pursue its marketing objective in the target market.

Marketing mix comprises decisions taken in the following four important areas:

1. Product
2. Price
3. Promotion
4. Physical distribution i.e. Place

The businessman has to prepare various strategies relating to the aforesaid elements i.e. in the fields of Product, Pricing, Promotion and Physical distribution. The last element i.e. physical distribution is also referred to as ‘place’. These four elements are popularly called four P’s of marketing mix.

Following diagram depicts the four elements of marketing mix.

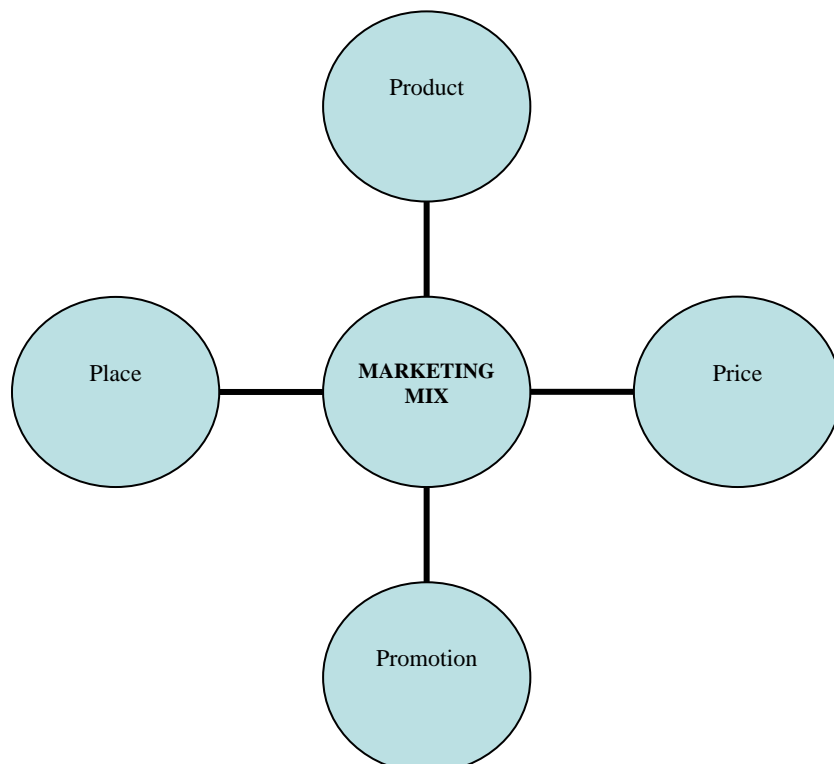


Figure 10.1: Diagram depicting four elements of marketing mix

Importance of Marketing Mix

A judicious mix of the four P's is very important for satisfactory marketing of goods. It will lead to consumer satisfaction, on the one hand and profit maximization, on the other. Marketing mix is thus, the main building block of marketing efforts of a firm. The importance of marketing mix is explained as under:

1. It leads to increase in sales and profits of the business firm.
2. It represents an integrated approach to marketing because a balance is maintained among its inter-related elements.
3. It serves as a linking-pin between the firm and its customers.
4. It helps in maintaining equilibrium between the business firm and its marketing environment.

10.3 MARKETING MIX – PRODUCT

Product mix is one of the important elements of marketing mix. The product element of marketing mix refers to a combination of various features relating to a product which is offered for sale. It signifies the product offered to the customer. It involves decisions concerning:

- Nature of the product
- Features of the product
- Branding
- Packaging
- Labelling
- Guarantees & warranties
- After-sale services

The above are also called sub-elements of product mix. Let's discuss these sub-elements of product mix one by one.

1) *The nature of product*

The details of nature and character of the product which are contained in the mix are related to:

- a) *Product line*: It refers to a group of products within a product class e.g. in the case of Amul Co-operative Society, butter constitutes one product line, cream constitutes another, milk a third one; and so on.
- b) *Product width*: The width of the product mix denotes the number of product lines that the businessman offers to the market. For example, Amul has wider product mix whereas MDH (Mahashya Di Hatti) has narrower product mix.
- c) *Product length*: It refers to the number of product items that are carried in a product line. The length of product line denotes the number of items in the line e.g. Amul carries a number of product items in butter line – it offers 'white butter' and 'salted butter'. Similarly Amul cheese may be 'cheese spread' or 'sliced cheese'.
- d) *Product Depth*: It refers to the total number of variants that are offered of each product item in the product line. In the case of Hindustan Lever Limited the soap Lux may be Pink, white or Lux international.

II) Features of a product

The decisions regarding features of a product are mentioned below:

- *Size*: The size of the product should be easy to handle. It should be convenient to carry and to use. For example, pack of Cadbury chocolate comes in manageable size.
- *Colour*: The colour of the product should be appealing. For example, the yellow colour of Brown & Polson custard.
- *Flavour*: The product should have a wide variety of appealing flavours like Priya Gold Biscuits are found in many flavours – pine-apple, elaichi, orange etc.
- *Weight*: A product should not be too bulky or too heavy. For example Saffola oil comes in one litre pack, Amul butter comes in 100 Gms. packs.
- *Durable*: A product should have a longer shelf life. For example Kissan tomato puree has a shelf life of 12 months.
- *Shape*: Solid products can be round (like Milk Bikis cream biscuits manufactured by Britannia); square (like Krack jack biscuits of Parle); rectangle (like Cadbury's Five Star chocolate) etc. In the case of liquid eatables they take the shape of their containers. For example Pepsi, Coke, Kissan sauce, Kanodia Mustard oil etc.

III) Branding

Branding is a way for an organisation to identify its products and distinguish them from those of the competitors. Branding is naming the product or giving a symbol or mark to identify the product. In other words, a brand is a name, term, sign, symbol, or design or a combination of them, which is intended to identify the goods or services of the seller. A brand distinguishes a product from similar other offerings. A successful brand is a major asset for a company. Following terms are associated with branding:

- *Brand name*: It is that part of a brand which can be vocalized or uttered e.g. Tata tea, Sunfeast cream biscuits, Harvest bread, Frooti, Rasna, Real juice, Haldiram's Navratan etc.
- *Brand mark*: It is that part of a brand that can be recognised. It is not utterable since it is in the form of symbol; design etc. e.g. Nestlé's 'Nest' or Mother Dairy's 'Drop'.
- *Trade mark*: When brand is given legal protection, it is called 'trade mark'. A trade-mark is a legal term protecting the seller's exclusive rights to use the brand name or brand mark. R in circle (i.e. ®) is used to show that the trademark is registered. A registered trade mark of a product cannot be used by another company. A trade mark is a registered brand name. It may not be pronounceable.

Classification of brands

Brands can be classified as under:

i) Family brand:

Family brand is one where a business man uses only one brand name for all his products. Amul, Everest etc. are examples that follow a family brand policy.

When one name is established as a particular brand, other products get easy and instant recognition. This method is simple and economical.

ii) Individual brands:

This refers to a brand name given for each individual product. The firm is able to create a distinct image for each of its products. It is a costly method.

iii) Company name

In this case Company's name is attached with each product name. Thus, the advantage of family brand and individual branding are combined. For example, Britannia is manufacturing different types of biscuits and in each type, brand name is preceded by the company's name i.e. Britannia like Britannia Cream Treat biscuits, Britannia 50-50 biscuits.

iv) Separate family brand name

The firm may follow different brand names or each class of their product i.e. the products are classified in different families and brand names are given to each family.

Selecting a brand name

To develop a brand name is one of the most difficult elements in development of a new product. A good product with a mediocre name may not sell well. Following aspects should be taken into account, while selecting a brand name:

- I) It should reflect some benefit and function of the product e.g. Hajmola brand name suggests digestion.
- II) It should be distinctive. It should portray status, power etc e.g. Diamond Masale; Jagat Basmati Rice etc.
- III) It should be easy to pronounce, spell and remember. One syllable name should be preferred e.g. Tata Tea, Amul butter etc.
- IV) It should be capable of being registered and protected legally. It should not be closely linked to an existing brand.
- V) It should be short e.g. Lijjat papad.

Advantages of branding

I. Towards producers

- a) It creates a new market due to its distinct identity.
- b) It becomes easier to advertise the product.
- c) New products can be added due to high sales and profits.
- d) The price of branded product can be easily increased, once the brand becomes popular.
- e) Less commission is offered to the intermediaries.

II. Towards customers

- a) It is easy for the customers to recognise the product.
- b) A feeling of satisfaction is created due to repeated use of the branded product.
- c) The consumers always get a branded product of good quality.
- d) Branded products are easily available at the retail outlet.
- e) Branded products are made available at a particular price.

IV) Packaging

Packaging refers to all the activities involved in designing and producing the containers or wrappers for a product. For example, rice is packaged in jute bags or plastic bags, ghee is packaged in plastic containers.

A package may be primary package or secondary package. A primary package refers to the products' immediate container. For example, small plastic pouch in which masale are packed. A secondary package is the additional layer of protection. It is generally removed and thrown once the product is ready for use. For example, card-board box of masale on which name of the product and the company is mentioned.

Kinds of packaging

i) Family packaging

A firm may adopt family packaging for all its products. Family packaging gives a common feature of appearance on all packages i.e. packaging will be similar for all the products.

ii) Re-usable packaging

A re-usable packaging can be used again for any other purpose. For example, usually house-wives store spices or pickles in 'Horlicks' or 'Boost' bottles; drinking water in 'Rooh-Afza' bottles etc..

iii) Multiple packaging

Several units of the same product are placed in one container. It is suitable for sale of small items. For example, several biscuits are placed in a single wrapper; several pieces of 'Britannia cakes' are placed in one package etc.

Material used in packaging

Different kinds of products are packaged in different types of material. Some of the examples are given below:

- Fruits are packaged in wooden boxes or card-board boxes or straw baskets.
- Processed food or oil is packaged in metal containers.
- Rice, Ghee, Chocolates etc. are usually packaged in plastic pouches or plastic boxes or plastic wrappers.
- Paper with wax coating is used to package toffees.
- Glass is used to package cold drinks, pickles, sauces, vinegars etc.
- Aluminium foil is used to package tea, coffee, toffees etc.
- Wheat is packaged in jute sacks.
- Tetra pack is used for packaging fruit juices, fruit drinks etc.

Forms of package

A package can take many shapes. Following are the examples:

- Fruit jelly is packaged in a tube form.
- Cold drinks are generally packaged in a bottle form of packaging.
- Tea, spices etc. are generally packaged in small unit packages like 250 gms package, 100 gms package etc.
- Candy, soups, pan masala etc. are usually packaged in sachets.
- Jars are used to package Desi Ghee, edible oil etc.
- Refill packs are used to package coffee, chocolate powder, tea etc.
- Cans are used to package fruit juices, cold drinks etc.
- Bags are used to package flour (atta), rice etc.

Benefits of packaging

- It is an effective advertising medium.
- It provides space in which the product can be contained.
- It helps in keeping the product safe from pests, rodents, moisture, rain etc.
- It helps in storage.
- It helps in product differentiation.
- It helps in increasing sales.
- It increases the shelf life.
- It ensures visibility of the product if the material is transparent.
- It ensures easy handling of the product.
- It makes the product attractive.
- It makes brand of a product popular.

- It protects the goods from pilferage and adulteration.
- It can be re-used.

V) Labelling

The term labelling means putting labels on the package or the product. A label is a small slip to provide information to the customers e.g. the name of the product, price etc. A label may be a piece of paper, printed statement, imprinted metal or leather which is attached either to the package or to the product. The label describes the nature of the product, contents of the package and other information like price, date of expiry, batch number, weight etc.

A label is a strong sales tool and an integral part of the point of purchase advertising. Labels are designed to help promoting a product.

Functions of labelling

Labelling serves the following functions:

- Identification of a product is easy for the customer.
- The manufacturer is able to grade the products into different categories, e.g. Hindustan Lever Limited (HLL) sells different types of tea under yellow, red and green label.
- It is a carrier of information.
- It provides information, which is mandatory by law.
- It attracts the buyers and draws them to buy the product.
- It helps in comparing the product.
- It leads to easy trading for retailers.

Features of a good label

- It should supply sufficient information.
- It should be easy to locate and read.
- It should be simple to understand.
- It should be colourful and attractive.
- It should help to make a buying decision.
- It should contain statutory information, if any.

VI) Guarantees and warranties

Guarantee is a policy adopted by the manufacturer with regard to his products in case any is found defective. It is an obligation assumed by the seller in which he promises the buyer that he will get certain services in future, including replacement, repairs etc.

Warranty is an assurance of quality, service and performance given by the producer to the consumer. It points out the responsibility of the

businessman for repairs, service and maintenance in the case of consumer durables.

VII) After sales service

After-sales service, as we all know, is required after the product has been sold. It is an important aspect of a marketing transaction. After-sales service covers repairs, changing parts at lower charges etc. These services are provided so that the customer is satisfied.

Check Your Progress Exercise 1



Note: a) Use the space below for your answer.

b) Compare your answers with those given at the end of the unit.

1. Under which category of branding do the products of 'KISSAN Brand' fall:
 - i) Family branding
 - ii) Individual branding

2. To which type of packaging 'Tata salt' belongs:
 - i) Primary packaging
 - ii) Secondary packaging

3. Write the name of the material in which 'Kanodia Brand' 'one kg mustard oil' is packaged:
 - i) Plastic; or
 - ii) Tin

4. The package of 'red chillies' is an example of multiple package or re-usable package.

5. The label of 'Rex Baking powder' carries information regarding directions for use, net weight, etc.
 - i) Yes
 - ii) No

10.4 MARKETING MIX – PRICE

The Price element of marketing mix refers to the price to be charged by the businessman. It is the source of revenue for the businessman and cost for the customer. Pricing is one of the most important decision-areas of marketing. This is the only area from where revenue is earned by a businessman. Pricing is crucial to profit as well. Price is the exchange value of a product. A low or a high price may mean success or failure for a businessman. Pricing is the process of translating the value of a product or service in terms of money. Prices not only determine what a businessman will get in return for the goods he has produced but it also has an impact on future production and marketing.

Importance of Pricing

- Price acts as a regulatory mechanism by means of which the buyer and the seller come to a mutually satisfactory understanding.
- Price determines the sales volume.
- Price determines the profit margin.
- Price affects the competitive position.
- Price affects the market share.
- Price determines the purchasing power and standard of living for a customer.

The various decisions taken by a businessman under price mix are as under:

- I. Pricing policy
- II. Pricing Strategies
- III. Discounts and Allowances

Let's now discuss these decisions in detail.

I. Pricing policy

A product has to be priced scientifically. Intuition has no place in this process. Pricing decisions have to be taken taking into account several factors. These factors are discussed as under:

Factors influencing pricing policy

- *Consistency:* Pricing has to be consistent with overall objectives of the firm, e.g. the firm's objective may be profit maximization or to achieve a high turnover. Accordingly, it may be a higher price or lower price.
- *Public image:* If the public image of the product is high the price may be kept high.
- *Purchasing power of the consumers:* If the purchasing power of the consumers is low, the price should be kept low.
- *Ability to postpone purchase:* If the consumer can think of postponing the purchase of a particular product, the price of such product should be kept low.
- *Pricing policy of the competitors:* The businessman should fix the price keeping in view the pricing policy of the competitors.
- *Availability of substitutes:* The price may be kept higher in case there is no substitute for the product available in the market.
- *Cost of production:* The price fixed should be such as would recover all the costs including a fair return to the businessman.
- *Demand and Supply:* If the demand of the product is higher than its supply the price may be fixed at a higher level. In case supply exceeds the demand, the price should be fixed at low level.

- *Current fashion and tastes:* If the product matches the current fashion and tastes, a high price may be fixed.
- *Price control measures:* The prices of certain products are controlled by the government. The businessman should fix the price keeping in mind the prevailing policies of the government.

II. Pricing strategies

Pricing strategies provide a framework within which pricing decisions can be taken systematically to achieve the pricing objective. Following are the different pricing strategies which may be adopted by the firm:

i) *Skimming pricing*

This is usually adopted to price a new product. A very high price is set in the beginning. The cream of demand may be skimmed and huge profits can be made. In other words, the product is offered to some buyers who are ready to pay much higher price than the others. This may be because the product has high present value to them or they are insensitive to price. Later on price may be reduced to tap other segments of the market.

ii) *Penetrating pricing*

In this case a low price is fixed to go deep into the market immediately. Due to low price the brand becomes popular and thereby market share can be maximized. It is an aggressive pricing strategy.

iii) *Price-discrimination pricing*

In this case product is sold at two or more prices. Different customers pay different amount for the same product. Price can be different on the basis of different locations as well.

iv) *Going-rate pricing*

Under this method, the firm sets its prices on the basis of what its competitors are charging. This system is preferred to keep harmony within the industry.

v) *Target pricing*

In this method, the businessman tries to determine the price that would give it a specified target rate of return on its total cost at an estimated standard volume.

vi) *Cost-plus pricing*

Here price is set on the basis of adding some fixed percentage to the unit cost. A cost estimate is done and a margin is added thereto for covering the marketing expenses and profits.

vii) *Loss-leader pricing*

Here the business firm sells some popular product at a very low price. The aim is to attract the customers to enter the shop. The customers who come to buy that item will stay on and buy other products which

are regularly priced. The products which are sold at low price are known as loss-leaders and therefore, the pricing strategy involving the use of loss-leaders is called the 'Loss-leader Pricing'.

viii) Prestige pricing

Under the system of prestige pricing, the price of the product is usually kept high on the basis that a high priced product will be sold better as the customer will think that quality of the product is reflected in the price.

ix) Odd pricing

Under this system of pricing, an odd amount is set for the product e.g. Rs. 599.95 in place of Rs. 600. This pricing gives a psychological feeling that the price is at a lower rung and the buyer is motivated to buy.

x) Marginal pricing

Here price is set to cover the marginal cost only and not the total cost. This method cannot be followed for a long period of time as it ignores the fixed cost.

III. Discounts and allowances

Discounts and allowances are granted by the businessman either to the customer or to the wholesalers and retailers. Discounts and allowances are offered with a view that the other person will provide some benefit by performing some marketing activities the value of which will be equal to the amount of the discount or allowance.

Types of discount

- *Trade discount:* It is allowed by the businessman to the wholesalers and retailers on purchase of goods in large quantity. The amount is deducted from the list price itself.
- *Quantity discount:* It is allowed by the businessman to a customer to encourage him to buy in large amount. It is offered because of a large single purchase.
- *Cash discount:* It is offered by the businessman to the wholesalers and retailers in order to get early payment. For example, when the wholesaler is required to make payment within 10 days of sale, he may be offered that if he makes payment early, say within 5 days, he will be given a cash discount of 5%.
- *Seasonal discount:* This discount is allowed by the businessman who is dealing in seasonal product. For example fans, coolers may be sold during winter season at a discounted price. Thus, he may offer discount if an order is placed during the slack season.

Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Name the following:

- i) A strategy where a high price is set in the beginning.

.....

- ii) An aggressive pricing strategy.

.....

- iii) A strategy where two or more prices are set.

.....

- iv) A strategy where price ends in odd amounts.

.....

- v) A strategy where purpose is not to get customers to buy the bargain itself but rather to buy other items as well.

.....

2. State true or false in Column (3):

| Sl. No. (1) | Statement (2) | True/False (3) |
|--------------------|---|-----------------------|
| 1. | Price influences plans for future production and future marketing. | |
| 2. | Pricing is the art of translating into quantitative terms the value of the product to the customers at a point of time. | |
| 3. | Price affects the competitive position. | |
| 4. | Price is used to increase sales volume to the level that matches the organisation expenses. | |
| 5. | Pricing decisions are influenced only by public image. | |

10.5 MARKETING MIX – PROMOTION

Promotion is yet another element of marketing mix. The promotion element of marketing mix refers to the activities related to the promotion of the product. The businessman has to take into account this element as well before deciding on any marketing activity. Promotion is a marketing effort done by the

businessman to inform about the merits of a product or service and to persuade actual or potential customer to buy.

Promotional strategy concentrates upon letting the product reach the target market through the marketing channels. In this process the businessman needs to communicate to target market and the wholesalers and the retailers so that sales take place as scheduled and his marketing objectives are achieved. Promotion is a communication tool in the hands of a manufacturer.

Promotion mix is the combination of different forms of promotion used by a businessman. The promotion efforts are directed at informing potential customers about the availability of right product and at the right place and at the right price. The core of promotion is communication. The businessman generally chooses a combination of promotional tools to achieve desired communication effect. The various decisions taken under promotion mix are as follows:

- I. Advertising
- II. Sales promotion
- III. Personal selling
- IV. Publicity

Let's now discuss the various decisions one by one.

I. Advertising

Advertising is a paid form of non-personal presentation and promotion of ideas, goods and services by an identified sponsor. In other words the communication is directed towards a target audience by the sponsor.

Advertising is spreading the information about an idea, product or service to the people. It is said to be non-personal due to absence of face-to-face contact with the customer. Advertising has mass appeal. It can influence large section of the society. It enables the buyer to know the new product available in the market.

Features of advertising

- It is non-personal in nature.
- It persuades the buyers to purchase the goods.
- It is a paid form of communication.
- It can reach a large section of the people.
- It provides information on the products and services to the customers.

Objectives of advertising

- To inform the customers about the product.
- To build an image of the product in the market.
- To increase sales.
- To support sales promotion measures.
- To build brand loyalty.
- To fight competition in the market.

Benefits of advertising

For consumers:

- It provides information regarding price, availability, quality etc.
- Comparison with other products becomes easier.
- It acts as a guarantee regarding quality.

For manufacturers:

- It increases the sale of the product.
- It helps in easy introduction of new product.
- It establishes contact between manufacturers and consumers.
- It helps build the image of a product.
- It enables them to face competition.

Types of advertising

1. *Product advertising*: The emphasis of product advertising is to inform the customers about the product manufactured by the firm. The purpose is to create a favourable attitude of the product in the minds of the customers. Hence, a desire is created to buy that particular product.
2. *Institutional advertising*: The emphasis of institutional advertising is to build the goodwill of the firm. The aim is to build a positive attitude towards the businessman.
3. *Primary advertising*: It is one of the forms of product advertising. This type of advertising is done to build a demand for a new product.

Media used in advertising

Let's evaluate the important media of advertising.

1. Newspaper

It is a form of print medium. It is a medium through which general public can be reached. The advertisements are inserted in the morning or evening editions or in Sunday edition of the newspaper. The newspaper may be circulating at a local level or state or national level. It can be an English language newspaper like Hindustan Times or Times of India or Asian News or The Hindu or a Hindi newspaper like Navbharat or Hindustan or Dainik Jagran or any other regional language.

Advantages:

- Newspapers have a wide circulation as national dailies cover a large geographical area.
- They offer more flexibility as shape, size, colour and appearance of the advertisement can vary.
- It is economical as it is cheap in comparison to other media.
- The response of the consumers is quick.
- Lengthy message can be transmitted through this medium.

Disadvantages:

- Life of newspaper is short.
- It may not be as attractive, for the paper used is not of good quality and printing may also not be very fine.
- Such advertisements are usually read in a hurry.
- Space allotted to the advertisement in the newspaper may be small.

2. *Periodicals*

Magazines/business journals are purchased for entertainment and information. They are published at periodical intervals like weekly, fortnightly or monthly. The advertisements can be placed in magazines like Woman's era, Femina, Outlook, India Today, Grih Shobha etc.

Advantages:

- It has a strong visual impact as it is colourful and appears on a fine quality paper.
- Such advertisements are read at convenience, in a relaxed mood as the magazine is generally read when the reader has sufficient time in hand.
- Such advertisements have long life as the magazines containing them are generally preserved and read repeatedly.

Disadvantages:

- It is costly to get an advertisement printed in a magazine.
- The advertisement may not appear at the desired time since the magazine is published periodically.
- The magazine has limited coverage.
- Lack of flexibility because changes in the contents of the advertisement may not be possible once the magazine goes for printing.

3. *Television*

As of now, TV is the widest and fastest growing medium. It creates a permanent impression in the mind of the viewers especially children.

Advantages:

- It has audio as well as visual impact.
- It is appealing.
- The advertised product can be demonstrated.
- It has wide coverage.

Disadvantages:

- It is very costly.
- Since the advertisement appears at a time which is not certain a person not watching TV at that time will miss it.

- Lack of flexibility as desired changes may not be incorporated.
- Small-sized companies cannot afford an advertisement on TV.

4. *Radio*

Radio advertising is very popular for the last so many decades. Radio is listened to by rich and poor, old and young, male and female alike.

Advantages:

- The message can reach the remotest place.
- It has wide coverage since all walks of people listen.
- It is a cheap medium of advertisement.

Disadvantages:

- Radio is only audio and has no visual impact.
- There are noise disturbances.
- It has got short message life.

5. *Outdoor advertising*

Outdoor advertising has gained popularity as an important medium in recent times. Its form can be banners, hoardings, billboards, posters, electric poles etc.

Advantages:

- It is attractive and colourful.
- Electric display of the advertisement on roadsides can be very effective.
- It builds awareness quickly.
- It has long life as there is repeated exposure.
- It catches the attention very quickly.
- Low cost.

Disadvantages:

- Limited creativity because such advertisement may contain very limited description of the product.
- The coverage is narrow as it has limited audience.
- It has a short attention span.

6. *Internet*

It is the latest form of advertising medium.

Advantages:

- It is effective.
- It is not costly.
- It is flexible as data can be changed without much difficulty.
- It can be attractive and colourful.
- It may contain lot of information about the product.

Disadvantages:

- Limited reach because advertisement can reach only highly selected audience.
- Problem of connectivity as the server may be down.
- Irregular electric supply may pose a barrier in reaching the advertisement.

7. *Film advertisements*

These types of advertisements are shown in the cinema halls before the main feature film is started or during the interval. In this case, short films or cinema slides are prepared and distributed to the cinema houses for display. The advertisement film contains pictures regarding the product and its uses along with a running commentary.

Advantages:

- It is colourful.
- The advertisement has got life-size pictures.
- It gets attention of the viewers sitting in the cinema hall.

Disadvantages:

- It has limited coverage because a handful of viewers can see the advertisements.
- The advertisement may be missed by those persons who enter the cinema halls a bit late or after the start of the feature film.
- It has short life.
- The preparation and display of advertisement is costly.

8. *Exhibitions and trade fairs*

Businessmen get a nice chance to reach the target market through various exhibitions and trade fairs organised in the cities. Good friendly relations can be built between the businessmen and the customers. Further, the customers get an opportunity to study the product, technical advantages, quality etc. The product can be demonstrated as well. This method is suitable for big manufacturers.

9. *Window display*

The goods are displayed beautifully in the windows at the entrance of the shop. The displays are made more attractive through the use of powerful coloured lights, glitters, show-cards, cut-out displays etc. Window display increases sales. The shopkeeper's time and energy in canvassing about the product are saved.

10. *Showrooms*

Showrooms are separate shops or rooms where the product line of the manufacturer is on display. The customer gets full idea of the product, price etc. A lot of literature in the form of pamphlets, booklets is also freely available. These are maintained in attractive style and goods are

displayed in popular style. Showrooms are maintained only by big manufacturers, retailers or wholesalers. Immediate sale can also take place.

Factors affecting the choice of media

Following are the various factors on which choice of the medium will depend:

1. Coverage

Large size of audience can be reached if media like TV, newspaper, magazine, radio are chosen. For selective coverage, film advertising or internet can be selected.

2. Flexibility

A businessman may want to change or modify his advertisement. The medium like TV, magazines may pose problems in changing the advertisement. Radio, newspapers, posters, hoardings are comparatively more flexible.

3. Cost Factor

Cost is an important deciding factor for the medium to be chosen. The benefits of the media should also be evaluated in terms of cost. TV, film advertisements, magazines are costly compared to newspapers or posters.

4. Life of the advertisement

All the media do not have the same life. Media like TV, newspaper, radio have a very short life. People forget the advertisements after looking at it. Magazines, business journals etc. have a long life as they can be preserved by the readers. Usually, people refer to these magazines, business journals etc. even after some gap of time.

5. Class of people

Illiterate people can be targeted through the medium of TV, film advertising, radio where reading is not involved. For literate people, internet, newspapers, magazines etc. are a good option.

6. Nature of product

Consumer goods can be promoted through media like newspaper, magazine, radio, TV etc. whereas industrial goods can be best advertised through business journals, trade fairs, exhibitions etc.

Objections to advertising

- It forces the people to buy goods.
- It leads to extravagance as the people particularly children are induced to buy products which they may not be requiring.
- It increases the cost of the goods.
- It may misrepresent facts.
- It may confuse people.

The above points, however, are not fully valid. The consumers, now-a-days, are very vigilant and alert. They have their own mind to think. Therefore, it is rather difficult to mislead them.

II. Sales promotion

Sales promotion is an important communication tool in the hands of the businessman. It refers to short term incentives offered to the consumers. Sales promotion techniques draw a quick response from the target customers. It induces the customers to take the purchase decision. Sales promotion efforts are best suited for new products. In spite of all these benefits, sales promotion lacks permanence because the customer usually goes back to the earlier brand of the product which he was using earlier, after the withdrawal of the sales promotion scheme.

Objectives of sales promotion

- To increase the sales volumes.
- To make the customers try a new product.
- To increase the frequency of use.
- To gain shelf space and display at the point of sale.
- To block competition.

Techniques of sales promotion

At the level of consumers:

- *Samples:* A business firm may distribute samples of the product free of cost to a few customers. It is an expensive method. It is useful to introduce new product in the market e.g. a firm may distribute free samples of tea in a small sachet in a particular colony.
- *Coupons:* A business firm may distribute coupons to the prospective customers. The customers can save money on presenting the coupons to the designated retailers to purchase a specified product within a specified time. The time may be as short as a day or may be as long as six months. The coupons can be distributed through mail, newspapers, magazines or retailers.
- *Premium:* Premium is an offer of a product free of cost on the purchase of another specified product. It is like giving a free gift on purchase of a product e.g. a spoon is gifted along with a glucose pack of 500 gms or a cup is offered along with a beverage.
- *Price-off:* It is an offer to the consumers which promises a certain amount of money off the regular price of a product. In other words, the businessman sells the product below the normal price. There may be 10% to 20% off on the price of a specified product.
- *Contests:* Various contests are organised where a customer is required to write a slogan or complete a sentence with catchy words. For example, the sentence may start with “I like this product because-----” and the prospective customer will be asked to fill in the blanks with suitable words. Attractive prizes are offered to the persons chosen by the business firms.

- *Quantity deal:* Quantity deal is a new trend where a unit of product is given free of cost if more number of units are purchased e.g. one Horlicks bottle may be given free on purchase of five Horlicks bottles at a time.
- *Demonstration:* Special shows may be organised where products are demonstrated. Demonstration of a product may be outside the shop as well.

Means of sales promotion

i) Advertising material:

Dealers are offered advertising material like attractive pamphlets, banners etc. Due to these attractive and colourful banners on the one hand consumers become aware of the product and on the other hand the shop looks decorated and beautiful.

ii) Contests:

Various contests are organised by the manufacturers so that the dealers are prompted to take more interest in the selling of the product. Attractive prizes are offered which include free trip to a foreign country.

iii) Demonstration:

The products are demonstrated to the dealers so that they understand the working of the product. This method of sales promotion goes well with electric gadgets and mechanical products.

iv) Buying allowance:

The dealer gets discount on the quantity purchased. This sales promotion technique induces the dealer to purchase in bulk.

Sales promotion at the level of salesmen

The aim is to attract the salesmen as they have a direct contact with the customers.

i) Bonus

Salesmen may be awarded bonus in case they achieve more than a particular target given to them.

ii) Contests

Contests may be organised to boost the performance of the salesmen.

III. Personal selling

The other name for personal selling is salesmanship. Personal selling or salesmanship is an art to persuade people to buy. It is a face to face oral communication with the potential customers to convince them to buy the product. Here, the seller personally or through his representatives (i.e. salesmen) tries to stimulate the needs and wants of the buyer. This way he makes efforts to satisfy the needs by making a sale. In this process the needs of the buyer are met and the seller (i.e. the businessman) earns a profit. Hence, both the parties benefit.

Salesmanship is not aggressive selling. It is, in-fact, winning over. The ultimate objective of salesmanship is creation and stimulation of demand.

Benefits of personal selling

To the consumers:

- The consumers get information about the existing and the new product.
- The product is demonstrated to the consumers.
- The salesman helps the consumers in making a choice.
- The consumers are guided in purchasing and using the product which will give them maximum satisfaction.

To the businessman:

- The salesman identifies the prospective customer for the businessman.
- He helps in creating demand for the new product.
- He helps the businessman in designing a product on the basis of customers responses and the taste, attitude and preferences of the customer.
- He helps in increasing the sales and profits of the businessman.
- He enables the businessman to design or alter the sales policies.

Qualities of a good salesman

A salesman performs a number of different activities in the process of selling a product. The efficient and effective performance of sales activities requires certain qualities in the salesman. Let's discuss these qualities one by one.

I) Physical qualities

- He should possess good and sound health.
- He should possess a pleasing personality.
- He should have an impressive voice.
- He should have energy to work.
- He should have a good posture and clean dress.

II) Mental qualities

- He should be intelligent.
- He should have sharp memory and foresight.
- He should have keen observation.
- He should be imaginative and flexible.
- He should be self-confident and patient.

III) Moral qualities

- He should be honest in his dealings.
- He should be kind and empathetic.
- He should be cheerful and reliable.
- He should be loyal to both the employer and the customers.
- He should be dependable.

IV) Vocational qualities

- He should have sufficient Knowledge about the history of the company, its policies and its goals.
- He should have sufficient Knowledge about the history of the product.
- He should have sufficient Knowledge about the rival products.
- He should have sufficient Knowledge about the consumer, his background and social standing.
- He should have sufficient Knowledge about how to make effective sales promotion.

V) Social qualities

- He should have good manners.
- He should be courteous.
- He should have team spirit.
- He should be co-operative.
- He should be friendly.

Steps involved in the process of personal salesmanship

I) Pre-sale preparation

The salesman should make his foundation strong by obtaining information about the product, company, rival products, sales strategies, social background, income and age bracket of the prospective customers.

II) Locating the potential customer

He then locates the potential buyer and identifies his needs. He should also find out the product used by the customers whom he is trying to contact.

III) Approaching

He should greet the customer warmly, introduce himself politely and then introduce the product.

IV) Presentation

He should show the product to the customer in such a way that the customer feels attracted towards the product. The salesman should also describe the features and uses of the product.

V) Demonstrating

He should then demonstrate the product explaining the method to use it.

VI) Convincing the customer

The salesman should try to convince the customer regarding the quality and usefulness of the product. He should also try to remove the doubts and objections in the mind of the customer.

VII) Closing the sale

After initial negotiations, deal should be made and sale closed in a cordial manner. The product should be handed over to the customer and in return the customer should make the payment to the salesman. He should also assure the customer of service in future.

IV. Publicity

Publicity is a non-sponsored and non-paid form of non-personal presentation of ideas, goods or services by the media voluntarily. The object of publicity is to form a public opinion. It is free of cost. The business organisation is not required to make any payment to the media.



Check Your Progress Exercise 3

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Name the following:
 - i) A paid form of non-personal presentation and promotion of goods and services.
.....
 - ii) A unpaid form of non-personal presentation and promotion of goods and services.
.....
 - iii) A sales promotion scheme where a gift is given along with the product.
.....
 - iv) A face-to-face form of oral communication.
.....
 - v) A cheapest form of advertising having a nation-wide coverage.
.....
2. Give any two advantages of inserting advertisement in a newspaper.
.....
.....
.....
3. Give any two disadvantages of radio as a medium of advertising the product.
.....
.....
.....

4. “An advertisement in TV creates a permanent impression in the mind of the viewers”. Why?

.....
.....
.....

10.6 MARKETING MIX – PLACE

The place or physical distribution of marketing mix refers to the various activities which are involved in transferring the ownership of the goods to the customers. Its aim is to make products available in right quantity at the right time and at the right place. Place mix involves decisions to be taken in order to make the product available in the market. Under this concept the decisions relate to transferring of ownership to the customers and to select the channels through which the product should reach the customers. Further, the manufacturer also takes decision regarding development of distribution system for physically handling and transferring of the product through these channels.

The Following decisions are usually taken under place mix:

- Channels of distribution
- Coverage
- Transport
- Warehousing
- Inventory control

Let’s discuss these decisions in detail one-by-one.

1. *Channels of distribution*

It refers to the path taken by the goods in their movement to the customers. It starts with the producer and ends with the consumers. In between there may be a network of inter-dependent organisations like agents, dealers, wholesalers, retailers, which help in the transfer of product.

Levels of channels

The businessman may sell the goods directly to the consumers (i.e. direct sale) or may use various channels in which case services of intermediaries are used for selling the product (i.e. indirect sale). Following are the various levels of channels starting from zero level where no intermediary is involved and ending with three-level where services of number of intermediaries are used.

a) *Zero-level channel*

Here no intermediary is involved between the producer and the customer. The producer directly sells to the customer. This is the shortest and the simplest channel. Goods can be sold through door-to-door salesmen, direct mail, own retail stores, tele-marketing, etc.

b) One-level channel

Here one intermediary is used in between manufacturer and consumer e.g. retailer. This method is popular when the retailers are big and can buy in large quantities.

c) Two-level channel

Here the services of wholesalers are taken along with the retailers. This channel is preferred where the producer has limited finance, market is widely scattered and the wholesalers are specialised.

d) Three-level channel

Here one more tier is added in way of middlemen like agents. This channel is preferred when the manufacturer cannot directly approach the wholesaler, wide market is to be reached and when the manufacturer carries a limited product line.

Factors affecting choice of channels

- i) Nature of the market:* A manufacturer of industrial products usually prefers a direct sale method whereas a manufacturer of consumer products sells the goods using various channels.
- ii) Size of the market:* A businessman sells the goods indirectly if size of the market is big.
- iii) Unit value:* The products of low unit value are sold through middleman and products of high unit value are sold directly.
- iv) Technically complex products:* A direct sale method is preferred where expert advice is required.
- v) Perishable products:* Such products usually have short channels.
- vi) Financial strengths:* The big and rich businessmen can adopt direct sale method whereas small businessmen sell their goods through middlemen.
- vii) Experience of the businessman:* A direct sale is preferred if the businessman has knowledge and experience of distribution.

2. Coverage

Under this the businessman decides regarding how many middlemen should be used in the distribution channel. In this respect the businessman can adopt the following strategies:

- a) Intensive distribution strategy:* Here the aim is to saturate the market. It is adopted where product is inexpensive, frequently purchased and the consumers want it in their vicinity.
- b) Exclusive distribution strategy:* Here the businessman sells his product to a particular middleman in a particular area. Exclusive distribution rights are granted to a particular distributor. This is usually adopted for the goods which may be expensive and to be consumed over a long time.

c) *Selective distribution strategy*: Here the businessman prefers to sell his product in a selected market area or through selected intermediaries. This is useful in branded goods.

3. *Transport*

Transportation helps to widen market and it bridges the distance between production and consumption centres. The various means of transportation used by the businessmen are:

- Roadways;
- Railways;
- Airways;
- Waterways; and
- Pipe-ways

Choice of the mode of transport depends upon relative cost of different modes, their speed, reliability, frequency, etc.

Transportation is a necessary function of marketing as most of the markets are geographically separated from the point of production.

4. *Warehousing*

The businessman stores the goods in the warehouse to protect them against fire, theft, pest, insects, humidity, etc. The businessman may have his own warehouse or may take on rental basis. The warehouse can be located near the place of production or near the market. A regular supply of goods to the customers at minimum possible cost is ensured through warehousing. Modern warehouses provide facilities for packing, blending, grading, labelling, etc. of the stored goods.

5. *Inventory control*

The businessman needs to maintain a particular level of stock to ensure product availability as and when the customers' demand arises. Holding of inventory involves cost of storage, cost of capital tied up in inventory, cost of spoilage, etc. Inventory control implies control over the size of inventory. The management should weigh the benefits of maintaining inventory against the cost and optimum level should be decided.

Check Your Progress Exercise 4



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Name the two functions of modern warehouses.

.....
.....
.....
.....
.....
.....

2. Name the channel (direct or indirect) to be adopted by a businessman in the following cases:

i) Mr. A manufactures big ovens used for manufacturing bakery items, each costing Rs. two lacs and above.

.....
.....

ii) Mr. B manufactures butter and cream.

.....
.....

iii) Mr. C manufacturing spices wants to cover a large number of consumers spread over a large geographical area.

.....
.....



10.7 LET US SUM UP

Marketing refers to all those activities which direct the flow of goods from the manufacturer to the ultimate user. The term marketing mix is usually used to refer to a particular combination of marketing variables which are controllable by an enterprise. Marketing mix comprises decisions taken in the four important areas i.e. product; price; promotion; and physical distribution. These four elements are popularly called four P's of marketing mix. Product mix involves decisions concerning nature and features of the product; branding; packaging; labelling; guarantees & warranties; and after-sale services. In the case of price mix, price is to be fixed scientifically. A low or a high price may mean success or failure for a businessman. The various decisions taken by a businessman under price mix relate to pricing policy; pricing strategies; and discounts and allowances. Promotion, another element of marketing mix involves various decisions taken in the areas of advertising; sales-promotion; personal selling; and publicity. Place mix involves decisions to be taken for making the product available to the customers. Decisions taken under place mix usually relate to channels of distribution; coverage i.e. how many middlemen should be used in the distribution channel; transportation; warehousing; and inventory control.

10.8 KEY WORDS

Strategy : A specific plan devised for a campaign and to counter the moves of the competitors.

Transportation : Movement of men and material from one place to another.

Statutory requirement: A requirement which is to be followed compulsorily as per prevailing law.

10.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES



Check Your Progress Exercise 1

1. Family branding
2. Primary Packaging
3. Plastic
4. Multiple packaging
5. Yes

Check Your Progress Exercise 2

1. i) Skimming
ii) Penetration
iii) Price discrimination
iv) Odd pricing
v) Loss-leader pricing
2. 1. True
2. False
3. True
4. True
5. False

Check Your Progress Exercise 3

1. i) Advertising
ii) Publicity
iii) Premium
iv) Personal selling
v) Newspaper advertising
2. **Hint:** Wide coverage; Lower cost as compared to other media of advertisement.
3. **Hint:** i) Having only audio impact but no visual impact.
ii) There are noise disturbances.
4. **Hint:** Advertisement on TV is appealing; the advertised product can be demonstrated.

Check Your Progress Exercise 4

1. **Hint:** i) Facilities for packing; ii) Facilities for blending
2. i) Direct
ii) Direct
ii) Indirect

10.10 SOME USEFUL BOOKS

1. Kotler, Philip: Marketing Management – Analysis, Planning and Control, Prentice Hall of India Private Limited, New Delhi.
2. Mamoria, C.B. and Mamoria, Satish (2003) Marketing Management, Kitab Mahal, New Delhi,

3. Ramaswamy, M.S. (2002) Marketing, Salesmanship and Advertising, Sterling Publishers Private Limited, New Delhi.
4. Ramaswamy, V.S. and Namakumari, S. (1998) Marketing Management (Planning, Implementation and Control-The Indian Context), Macmillan India Limited, Delhi.
5. Varshney, R.L. and Gupta, S.L. (2000) Marketing Management (An Indian Perspective), Sultan Chand and Sons, New Delhi.

10.11 ASSIGNMENTS

1. Mention the various decisions taken under product element of marketing mix.
2. Mention various advantages of branding available to the consumers.
3. Explain various kinds of packaging.
4. What is a label? Mention the qualities of a good label.
5. "Price acts as the regulatory mechanism by means of which buyer and the seller come to a mutually satisfactory understanding". In the light of this statement explain the importance of pricing.
6. Discuss in brief the various pricing strategies.
7. Explain the factors that influence price.
8. As a publisher you have published a book titled 'Methods of Value Addition to Various Agricultural Products'. How will you set the price of the book?
9. Why is marketing mix important for a businessman?
10. Explain the various factors which affect the decision regarding the medium of advertising.
11. You are a manufacturer of 'Noodles'. Which media of advertising would you choose to increase your sales?
12. The life of contests as a sales promotion technique is short-lived. Do you agree? Give reasons.
13. Explain the various qualities of a salesman.
14. Explain the various factors affecting the choice of channels.

UNIT 8 PREPARATION OF THE BUSINESS PLAN

Structure

- 8.0 Objectives
- 8.1 Introduction
- 8.2 Meaning of Business Plan
- 8.3 Why a Business Plan is Needed?
- 8.4 Inputs required for a Business Plan
- 8.5 Preparation of Project Report
- 8.6 Project Appraisal
- 8.7 Common Errors in Formulation of Business Plan and Remedies Thereof
- 8.8 Let Us Sum Up
- 8.9 Key Words
- 8.10 Answers to Check Your Progress Exercises
- 8.11 Some Useful Books
- 8.12 Assignments

8.0 OBJECTIVES

After studying this unit, you should be able to:

- know about the business plan;
- understand the need for business plan;
- identify various inputs of business plan;
- know the challenges faced during the preparation of business plan;
- comprehend the common errors faced in a business plan; and
- understand how to avoid such errors.

8.1 INTRODUCTION

The term ‘business plan’ consists of two words – business and plan. Business is an economic activity. It is associated with buying, selling and manufacturing of goods with a view to earning profit and making a living. The people who engage themselves in a business are known as businessmen or entrepreneurs. Plan is a course of action to achieve a desired result. To plan is to look ahead. It is to assess the future and make provisions for it. Owing to planning a businessman is able to identify various alternatives and after proper evaluation, select the best alternative.

The term business and plan go together. In a business whether small or big a businessman has to plan continuously for one aspect or the other. He needs to know whether his business idea is a promising one or not and he requires a step by step investigation and development of sound business idea. Hence, the need arises for him to make a business plan.

8.2 MEANING OF BUSINESS PLAN

To start with, a businessman goes through the process of identifying various opportunities for the business. He studies the feasibility of various business proposals. He tries to determine the desirability of investing in a particular idea. He tries to establish the viability from different angles such as technical, marketing, financial, economic, managerial etc. If the resulting data show a non-viable project, the various parameters can be adjusted. A particular project can be abandoned if it proves to be not viable despite all alterations. Thereafter, feasibility of a new project should be analysed. If the idea is a promising one then a proper analysis should be done in respect of market, technical, and other aspects. In other words, make a business plan i.e. plan for the business.

A business plan involves step by step investigation and development of a sound business idea. A business plan can be said to be a comprehensive course of action with guidelines for a new venture. It covers the full range of business planning activities. It helps the entrepreneur to make better decisions. A business plan is also called feasibility plan. It is the systematic development of a project idea for the eventual purpose of arriving at an investment decision.

Who will write the Business Plan?

The businessman himself is responsible for planning as no other person will have the same motivation vision or foresight. He is, therefore the best person to draw up a business plan. In case, he is unable make the business plan himself he can take services of counselling organisations who deal in new venture planning. Various State Agencies like the Small Industries Service Institute (SISI), Small Industries Development Organisation (SIDO) etc. which are established to encourage venture development, also help the entrepreneur in this regard. For larger projects, a project team can be set up consisting of experts like industrial economists, market analysts, engineers, management accounting experts etc.

Example

Krishna Kumar has several business ideas in his mind. He can start manufacturing biscuits and cookies at a small level or make plastic refill bottles or simply become a wholesaler. After initial screening, he realises that last two ideas are not feasible and so abandons those ideas. He, then, starts making a business plan for the idea which he thinks is a promising one.

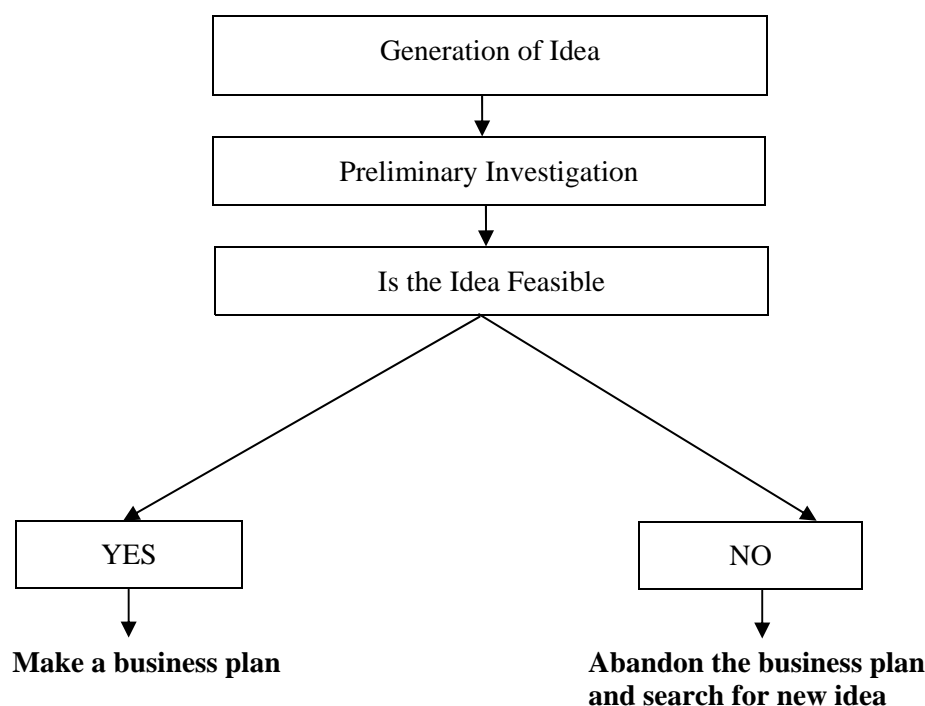


Figure 8.1: Diagrammatic representation of whether to make a business plan or abandon it and search for new idea

8.3 WHY A BUSINESS PLAN IS NEEDED?

A businessman needs a business plan because it serves the following purposes:

1. *Provides framework*

A business plan provides a framework of future activities of the enterprise. Consequently, it will also shape the future pattern of services. It will provide an initial effort to show that a business idea can be realised and will provide reasons as to why it will succeed.

2. *Initiates development*

A business plan will initiate the process of development. He can plan his production targets, employment, income generation and so on.

3. *Helps in arranging financial assistance*

A business plan acts as the best means for obtaining the required assistance from financial institutions. A project report can be prepared on the basis of business plan and after proper analysis the businessman can get the required amount of money in the form of loans.

4. *Helps in selecting appropriate technology*

A business plan helps the entrepreneur to examine his project idea thoroughly as regards its design, production, and technology to be used etc.

5. *Helps in securing clearances from the government*

A business plan is also of great help in obtaining necessary clearances from the Government. A businessman can prove his credentials with the help of a well formulated business plan. The procedural formalities can be easily

cleared. A business plan will pin point the matters for which Government sanctions have to be obtained.

6. *Provides knowledge about government regulations*

A business plan helps a businessman in understanding various government directives, import and export policies etc. Scanning the 'guidelines for industries' published by the Ministry of Industry, a businessman can obtain information regarding industrial policy, licensing procedure, foreign collaboration, foreign exchange orders etc.

Features of an Ideal Business Plan

Following are the important features of an ideal business plan:

1. It should be written in simple language.
2. It should be informative.
3. It should clearly identify the products, services, markets and promoters of the business.
4. It should be complete and accurate.
5. It should be convincing so that the bankers are able to sanction loans.
6. It should be dynamic in nature.
7. It should have a pragmatic approach.



Check Your Progress Exercise 1

Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Fill in the blanks.
 - i) A business plan is a broad set of ----- for new venture.
 - ii) A plan is to look -----.
 - iii) An idea which is not feasible should be -----.
 - iv) A project report can be prepared on the basis of -----.
 - v) A business plan should have a ----- approach.
2. Name two organisations from where a businessman can avail services to make a business plan.
 - i)
 - ii)
3. State True or False
 - i) A business plan should be static in nature.
.....
 - ii) A business plan should be informative,
.....

iii) The entrepreneur should refer the ‘guidelines for industries’ before making a business plan.

.....

iv) A project team is required for small projects.

.....

v) A banker is the best person to write a business plan.

.....

8.4 INPUTS REQUIRED FOR A BUSINESS PLAN

A business plan, also known as feasibility plan, comprises several elements which should be taken into account. Following inputs go into the making of a business plan:

- I. Information about the Industry
- II. Information about the Enterprise
- III. Information about Product/Service
- IV. Information about Market Research
- V. Information about Market Plan
- VI. Information about Operation Plans
- VII. Information about Finance

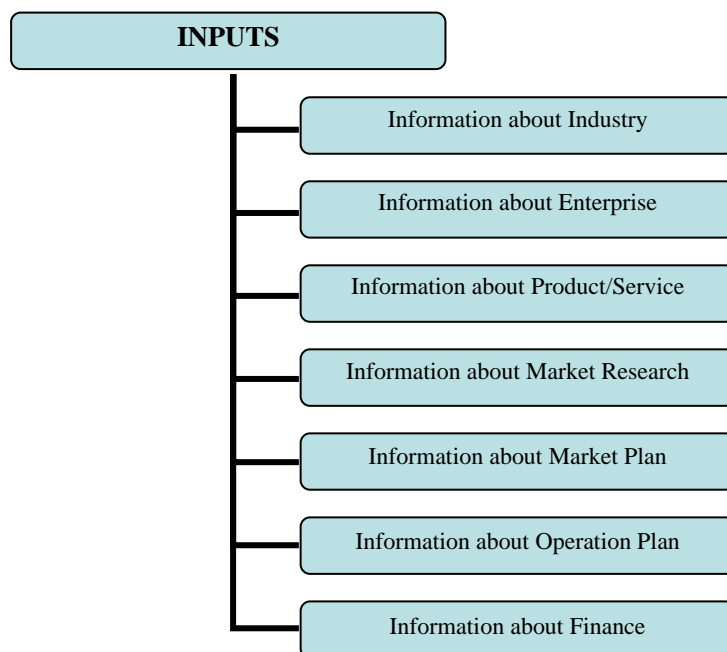


Figure 8.2: Diagrammatic representation of inputs that go into making of a business plan

Let's, now discuss these inputs one by one.

I. Information about the industry

A business plan, to start with, should contain an analysis of the industry. It should contain information like type of industry, its past and present performance, allocation of investment of funds, choice of technique etc.

II. Information about the enterprise

Information about the enterprise includes analysis of past performance, capacity utilisation, profitability etc. The purpose of the new venture (like manufacturing, processing, trading, providing services etc.) should be clearly defined. Forms of business organisation (like sole proprietorship, partnership, company, co-operative etc.) should also be mentioned.

A business plan should describe the entrepreneurial team as well. The skills, qualification, strength, talent etc. of the founding entrepreneur (also known as promoter) and other key personnel which are essential for the success of the firm must be described. The role of each person in the new venture should also be described briefly.

III. Information about product/service

Every business plan should explain its product to be sold or service to be offered. Usually, following points are described:

- Name of the product to be manufactured.
- The stage the business firm has reached to develop the new product e.g. whether such product is at research stage, design stage, testing stage, etc.
- The quality of the product.
- Price of the product.
- Method of using the product
- Material required.
- Cost of the product.
- Method of manufacture (e.g. technology profile).
- Legal protection (e.g. patents, trade mark, copy right etc.).
- Potential of substitute product which may pose competition.
- Licence requirement.
- Diversification plan.

IV. Information about market research

Under this head, the findings of market research should be provided so that it can be proved that a market really exists for the proposed venture. The entrepreneur must provide a summary of the following important points:

- i) *Potential customers:* Information about potential customers helps in explaining the market size and likelihood of generating sales. Following factors are analysed under this head:
 - Age of the customer
 - Gender of the customer
 - Family income
 - Occupation
 - Location
- ii) *Market:* A business plan is a forecast for the present and future market. It includes information about market trend etc.

iii) *Competitors*: A business plan should provide information about the potential competitors. This includes:

- Identification of existing competitors.
- Explanation of their strengths and weaknesses.
- Impact of the new venture on the rivals.

iv) *Pricing system*: Under this head the following information should be analysed:

- Price of the product
- Credit Policies
- Discount system
- Pattern of Allowances

v) *Distribution system*: As regards distribution system, methods of distribution should be analysed. These methods include:

- Direct Sales through showrooms, mail etc.
- Distribution through retail houses.
- Distribution through wholesale establishments.
- Distribution through franchising system.
- Distribution through telemarketing.
- Distribution through door-to-door selling.

V. Information about market plan

A market plan can be made after proper market research. The purpose of this input is that the reader of the plan (i.e. businessman himself, investor, banker etc.) must be convinced that a viable market exists and the enterprise has a good opportunity to serve this market. It describes the intended strategy of a businessman. Following inputs should be provided:

- Product – quality, use etc. of the product.
- Pricing System – pricing method, discounts, allowances, taxes and duties, quantity, etc.
- Promotion – branding, advertising, demonstration, gifts, coupons, etc.
- Distribution – use of market channels or other approaches.
- Services – after sales service policies, installation and repair services, guarantee and warranty of a product, etc.
- Names and designations of the persons responsible for marketing and sales.

VI. Information about operation plans

Under this head the following important aspects shall be covered:

- Choosing a location
- Purchasing property
- Parking and transportation services
- Dealing with legal issues
- Renovations
- Equipment and technologies
- Inventory management
- Human resources
- Quality control

- Insurance
- Patents
- Copy-rights

VII. Information about finance

Money is one of the important measures used to gauge the progress of a firm. Hence, a business plan should include projections of financial statements which are based on operating and marketing assumptions.

A projected profit & loss account is required to show net profit. A projected balance sheet will reveal the financial position by showing the balances in various assets and liabilities accounts. A break-even analysis will reveal when the enterprise shall begin to earn a profit. A projected cash flow statement will show the movements of cash in and out of the firm and its net impact on the cash balance with the firm.



Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Mention any two points regarding enterprise which should be stated in the business plan.
 - i)
 - ii)
2. Who can be a part of entrepreneurial team?
 - i)
 - ii)
3. Match the following:

| Column I | Column II |
|-------------------------|-------------------------------|
| 1) Market plan | A) Projected income statement |
| 2) Operation plan | B) Potential customers |
| 3) Financial plan | C) Use of market channel |
| 4) Production | D) Renovation |
| 5) Market research plan | E) Patents |

8.5 PREPARATION OF PROJECT REPORT

Meaning of Project Report

A project report is a formal version of a business plan. It gives a complete analysis of inputs and outputs of the project. It enables the entrepreneur to understand at the initial stage whether the project is sound on technical, commercial, financial and economic parameters. On the basis of project reports an entrepreneur takes his decision on whether to proceed on the proposed

project or not. The financial institution will also base their decision to extend finance and other support on the basis of the project report. A project report also helps in convincing the investors operating in the money market to invest funds in the business.

It is necessary to prepare a project report according to the format of the loan application of the concerned term lending institutions. The project report can be made either by the entrepreneur himself or by a consultant.

Aspects covered under a Project Report

A project report provides a bird's eye view of all the activities of a business firm. The various aspects of the information have to be systematically estimated and presented mentioning the various opportunities and constraints.

A project report includes information on the following aspects:

- i) Economic aspect
- ii) Ecological aspect
- iii) Marketing aspect
- iv) Technical aspect
- v) Financial aspect
- vi) Managerial aspect

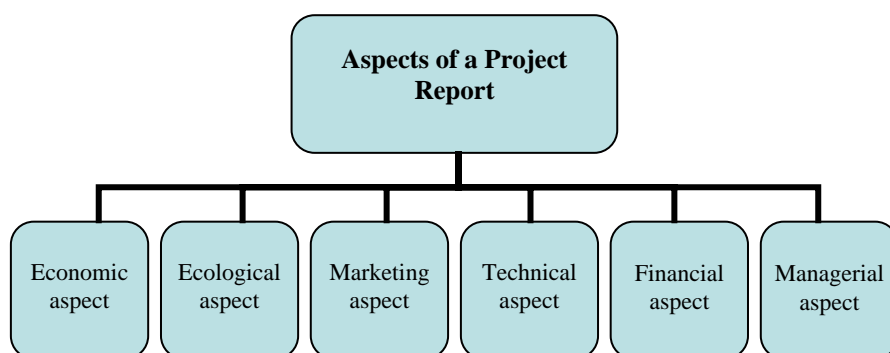


Figure 8.3: Diagrammatic representation of various aspects of a project report

Let's now discuss these points one by one:

i) *Economic aspect*

It is also referred to as social cost benefit analysis. It is concerned with judging a project from the larger social point of view. Under this, social costs and benefits are analysed. The impact of the project on the distribution of income, level of savings and investments in the society are analysed. It is to be seen that how much employment, self-sufficiency etc. the project will generate.

ii) *Ecological aspect*

Environmental concerns have assumed a great deal of importance in the present scenario. Ecological analysis is to be done for major projects which have ecological implications like power plants and irrigation schemes and environmental polluting industries. The likely damage caused by the project to the environment is to be seen.

iii) *Marketing aspect*

The project report should indicate demand for the product and the market share the project under appraisal can obtain. Information regarding consumption trends, structure of competition, elasticity of demand, distribution system, marketing policies, legal constraints, cost, preferences and requirements of consumers, etc. should also be mentioned. In other words a detailed market plan, specification of a proper marketing strategy and the manner in which the marketing process would be undertaken should be stated.

iv) Technical aspect

The appropriate report should give details about the techniques and technologies needed, equipments, raw material, machinery, power and other inputs required and the sources of their availability. This aspect covers the optimal scale of operation. Information regarding location and site, size, plant capacity, etc. needs to be mentioned.

v) Financial aspect

The report should indicate the amount of capital required. The amount to be contributed by the proprietor should be mentioned and the various other sources of finance should be indicated. Expected rate of return should be specified. Cost of project, projected profitability, break-even point, cost of capital, level of risk, projected financial position should be clearly indicated.

vi) Managerial aspect

The report should contain qualification and experience of the entrepreneurs and key personnel i.e. the persons who will be managing the show.

Contents of the Project Report

Following are the various particulars in brief to be given in a project report:

- i) General details about the industrial concern, project and financial assistance applied for.
- ii) Bio-data of promoters with past history.
- iii) Particulars of the industrial concern comprising:
 - A brief history.
 - Proprietor's/partners' bio-data.
 - Full details of revaluation of assets together with the reasons therefor.
 - Bio-data of key technical and executive staff.
 - Existing long term and short term borrowings.
 - Particulars of production and sales.
 - Locational advantages.
 - Existing requirement of various utilities and services.
 - Details of exports and incentives.
 - Details of Insurance.
- iv) Particulars of the project comprising:
 - *Capacity* – Present and proposed installed capacity, maximum production achieved and planned

- *Process* – Details of technical process, labour intensiveness of the process, reasons for choosing a particular process.
- Technical arrangement – Details of the technical arrangement made or proposed, write up on the collaborator, copy of the Government approval for the collaboration etc.
- Management.
- Location of land
- Building
- Plant and machinery
- Raw material
- *Utilities* – Details about power, water etc.
- *Effluents* – Details of the nature of atmosphere, soil and water pollution likely to be created by the project and measures proposed for control of pollution.
- Labour.

- ii) Cost of the Project.
- iii) Means of Financing.
- iv) Marketing and selling arrangement.
- v) Government consents.
- vi) Requirement of raw material.
- vii) Particulars of machinery to be imported.
- viii) Margin money for working capital.
- ix) Source of funds in respect of expenditure already incurred.
- x) Cash Flow Statement.
- xi) Projected Balance Sheet.
- xii) Projected Income Statement.
- xiii) Calculation of wages and salaries at maximum production.
- xiv) Unit cost of production.
- xv) Declaration that the above particulars are true and correct to the best knowledge and belief of.

Check Your Progress Exercise 3



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. State True or False.

i) A project report is an incomplete analysis of inputs and outputs of the project.

.....

ii) A project report serves as a guide to management.

.....

iii) A project report can be prepared by anybody.

.....

iv) A project report contains economic and financial aspects only.

.....

v) A project report is needed by an entrepreneur for carrying out expansion or starting a new production line.

.....

2. Read the following paragraph and fill in the blanks with appropriate words given below:

(entrepreneur, financial institutions, analyse, expert, feasibility)

A project report is prepared to ----- the extent of opportunity in the contemplated project. It is prepared by the----- himself or an ----- after detailed study and analysis of the various aspects of a project. The ----- insist upon such a project report in order to be sure about the ----- of the project.

8.6 PROJECT APPRAISAL

In the preceding paragraph we learnt that the entrepreneur has to submit a project report to his bankers in order to avail loan facility from them. The bank/term-lending institutions after receiving the loan application along with project report critically scrutinise it. They intend to ascertain the possibility of generation of funds by the project itself and whether or not it would be substantial enough to repay the amount advanced within the fixed time. The following paragraphs focus on what goes on in the minds of financial institutions while they appraise the proposal.

Let's now discuss the system of project appraisal.

Meaning of Project Appraisal

Project appraisal is the assessment of a project by a bank/term-lending institution. It is a complete and critical scanning of the project. It is the analysis of cost and benefit of the proposed project. It is important for a bank/term-lending institution to appraise a project because the resources are always limited and choice among alternative projects has to be made.

Method of Project Appraisal

The method of analysis of a project report usually varies from project to project i.e. method of analyzing a project by Canara Bank may be different with that of Delhi Financial Corporation. The various aspects that are taken into account by the appraiser are examined below:

i) Economic viability

The larger projects may be critically evaluated by the lending institutions by taking into those factors which have an economic and socio-cultural

impact on the society. The appraiser will examine whether the project will lead to increased output, increased employment, larger Government revenues, higher standards of living, increased national income, utilisation of indigenous raw-material, etc.

ii) Ecological viability

Effect of the project on the environment with particular emphasis on the pollution of water and air caused by the project is examined. The arrangement for effective disposal of effluents as per the Government policies is also judged. Energy conservation devices etc. employed for the project are also analysed. This analysis is done for big projects.

iii) Technical viability

All factors relating to infrastructural needs, technology, availability of machines, materials etc. are required to be scrutinised. Following are some of the important points which are usually examined under this head:

- a) Size of the available land to meet the present requirements and future expansion plans.
- b) Locational advantages in terms of transport facilities, proximity to market, infrastructural facilities like availability of water, power, labour etc.
- c) Position of availability of licences, if required from the Central or State Governments.
- d) Technology selected and method of manufacture.
- e) Technology collaboration, if any.
- f) Ready availability of plant and machinery.
- g) Arrangements for servicing of the machinery, supply of spare parts etc.
- h) Scale of operation.
- i) Plant layout and plant capacity.
- j) Detailed specification and the quantity proposed to be manufactured for, say, five years.
- k) Specifications for raw material and sources of supply.

iv) Marketing viability

Any project can be commercially viable only if it is able to sell its products at a profit. For this purpose, demand and supply pattern of that product is examined. Various methods like trend method, regression method for estimation of demand are employed which are then matched with the availability of particular product. Some of the important aspects which are analysed under this heading are given below:

- a) Study of demand forecast.
- b) Market potential.

- c) Position of other competitors.
- d) Distribution channels.
- e) After sale-service.
- f) Capability of the organisation to survive even under the adverse circumstances.

v) *Managerial viability*

The background of the founders or promoters of the project is also closely examined by the lending institutions. The project report should also highlight the strengths and weaknesses of the management by commenting on qualification, experience, potential, etc. of the key personnel. Following points are usually critically observed:

- a) Organisation Chart clearly defining various ranks and their jobs.
- b) Functions assigned to various managers.
- c) Communication channels.
- d) Delegation of authority and responsibility.
- e) Labour relations.
- f) Workers' participation in management.
- g) Turnover rate.
- h) Social security.
- i) Working conditions.
- j) Fringe benefits.
- k) Qualification and experience of the founders/promoters.
- l) Training programmes.
- m) Internal control systems.

In short, the appraiser wants to be sure that the project is adequately carried out through a well-staffed organisation which is capable of contributing effectively to the success of the project and organisation thereby. The qualification and past experience of the founders is assessed to know their capabilities for implementing the project.

vi) *Financial viability*

The real objective of the appraisal of the financial aspect of a project report is usually to examine its financial condition for the sound implementation of the project. The financial institution wants to ensure that the business firm is in a position to manage its business in a cost-effective manner as well. Financial viability of the project is also seen to assess whether a project would be in a position to generate enough surplus for timely payment of interest and servicing of debt in a reasonable period of time. The financial aspect of project appraisal covers the following areas:

A) *Cost of project*

- Cost of land and building
- Cost of plant & machinery
- Furniture and fixtures
- Office equipments
- Interest during construction period

- Margin money for working capital
- Preliminary expenses

B) Sources of finance

- Owned Capital
- Unsecured Loans from friends and relatives
- Term Loans from financial institutions/commercial banks
- Deferred Term Credit
- Subsidies and Development Loans

C) Projected income statement

Trading account provides net sales figures and details of direct expenses relating to raw material, wages, power, fuel etc.

Profit & loss account provides figures of net profit after taking into account expenses like salary, office expenses, selling and distribution expenses, interest, depreciation etc.

D) Projected balance sheet

The lending institution will study the projected balance sheet as well which gives the position of assets and liabilities of the business unit at a particular time. It shows the assets and liabilities of a firm.

E) Break-even analysis

A break-even point of a business enterprise is the level of output or sales at which the business enterprise just breaks-even i.e. there is neither a profit nor a loss. The formula for calculating break-even point (BEP) is as under:

$$\text{BEP (in Units)} = \frac{\text{Total Fixed Costs}}{\text{Selling Price per unit} - \text{Variable Cost per unit}}$$

A unit should always work above the break-even point to earn profit.

F) Financial ratios

While analysing the financial aspect of a project, study of financial ratios is quite important. These ratios can apprise the financial institutions about the liquidity position, solvency position of a firm over a period of time. The financial ratios which are usually analysed are:

- Debt-Equity Ratio
- Debt-Service Ratio
- Current Ratio
- Liquid Ratio
- Stock Turnover Ratio
- Debtors' Turnover Ratio
- Return on Investments
- Working Capital Turnover Ratio

G) Projected cash flow statement

A projected cash flow statement is a summary of all the sources of cash available (cash inflows) during the course of operation within a period of time and its possible uses (cash outflows) during that period. While appraising the project the banker, with the help of this statement, can find out the total surplus funds created during the operational year for which it is prepared. This information helps to determine the capacity of the project to service its debts and fix the repayment period and moratorium period of loan.

H) Pay back period

While carrying out project appraisal the banker considers a project more favourably which has shorter pay back period. This period refers to the length of time which is required to recover the initial cash investment made in a project. A project with a shorter pay back period is always preferred.

I) Discounted cash flows

Under pay back period the cash flows are considered without taking into account the time value of money. It may be noted that the value of a particular amount received after five years is not similar to the value of same amount which is received today.

For example, there is a difference between Rs. 10,000 which is received after five years and which is received today. If we compute the present value of Rs. 10,000 which shall be received five years hence, it must be discounted at a particular rate of interest to know its present value.

The banker shall consider the present values of the future cash flows and compare it with the initial investment. If the result is positive i.e. the present values are more the project shall be acceptable.

J) Internal rate of return

At the time of appraisal the bankers also consider the internal rate of return (IRR), also known as accounting rate of return. IRR means the discount rate which equals the present value of investment in the project to the present value of future returns earned during the life time of the project. IRR indicates earning capacity and a higher IRR indicates better prospects for the project.

8.7 COMMON ERRORS IN FORMULATION OF BUSINESS PLAN AND REMEDIES THEREOF

Common Errors in Business Plan Formulation and Remedies

Following Table indicates the various common errors which may be committed while formulating a business plan. The Table also contains remedies which will help in avoiding such errors:

Table

| Common errors | Remedies |
|--|--|
| i) The entrepreneur may make heavy investment in land and building in the initial stages which may result in un-economic working due to heavy interest burden on un-productive assets if these are under-utilised. | At the initial stages heavy investment in un-productive assets should be avoided. Such investment may be diverted for purchasing imported machinery and good quality raw material. |
| ii) Plant and machinery purchased is unbalanced i.e. the capacity at various stages of production is not matched to give the desired output which may result in low production. | A critical analysis of the various technical factors can help the entrepreneur to prevent the unit from getting into difficulties at a later stage. |
| iii) The management is ineffective in controlling functions like production, marketing, finance etc. | Experienced personnel should be recruited. Their roles should be clearly defined with proper delegation of authority. |
| iv) The business is more at risk if decision making in all areas is in the hands of one man i.e. one man show. | The businessman should keep important decisions in his hands. Routine business activities should be delegated. Principle of ' <i>management by exception</i> ' should be followed. |
| v) Promoters are weak in respect to experience, qualification etc. | Experts may be roped in either as partners or employees or consultants. |
| vi) The project report may not show enough profits to service its debts and for future development. | Avoidable and unnecessary expenditure may be reduced. |
| vii) A project report when written by the businessman himself may contain mistakes. | The project report may be prepared with the help of experts. |
| viii) Projections given in the project report are only for short period. | The project report should contain projections for at least five years. |
| ix) Wrong and unrealistic estimations are incorporated in the project report. | Wrong and unrealistic estimations should be avoided. The estimations should be based on authentic information. |
| x) Insignificant ratios like Fixed Assets Turnover Ratio, Fixed | Significant ratios like Current ratio, Debtors' turnover ratio, Debt service |

| | |
|--|---|
| asset ratio etc are given in the project report. | coverage ratio, Debt equity ratio etc. should be invariably incorporated. |
| xi) Wrong estimate of fixed capital are incorporated in the business plan leading to long term adverse effects on the financial position of the enterprise and also on its profitability. It may lead to over/ under capitalisation. | With careful planning the businessman should correctly estimate the fixed capital so that there is no under or over capitalisation in the long run. |



Check Your Progress Exercise 4

Note: a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Tick the correct option from the following alternatives:

- i) A project report is appraised by:
 - a) Banker
 - b) Businessman
 - c) Central Government
 - d) Reserve Bank of India
- ii) The financial projections appraised are:
 - a) Projected income statement
 - b) Projected financial position
 - c) Both of the above
 - d) None of the above
- iii) The purpose of project report appraisal is to:
 - a) Recruit financial manager
 - b) Buy land and building
 - c) Sanction term loan
 - d) None of the above
- iv) The banker will examine:
 - a) Technical viability
 - b) Economic and Financial viability
 - c) Marketing viability
 - d) All of the above
- v) The point which may go against the promoter:
 - a) Good Qualification
 - b) Wide Experience
 - c) Works on whims and fancies
 - d) Sharp business acumen

2. Mention any two points which will be examined by the bank at the time of project appraisal.

.....

.....
.....
.....
3. Mention any two common errors which a project report may contain.

.....
.....
.....
.....

8.8 LET US SUM UP



Business plan is prepared to assess the future and make provisions for it. A businessman studies the feasibility of various business proposals. He takes up only that idea which is promising one. With this idea in hand, a proper analysis should be done in respect of market, technical, and other aspects. At this stage, the business plan which involves step by step investigation and development of a sound business idea should be prepared. Besides businessman himself, the business plan can be written with the help of experts also. A business plan is required because it provides a framework for the future activities of the enterprise. It helps in initiating development, arranging financial assistance, securing clearances from the Government, selecting appropriate technology etc. The important inputs that go into making of business plan include information about the industry, enterprise, product and service, market research, market plan, operation plans, and finance. A project report is a formal version of a business plan. A project report includes information about the various aspects like economic aspect, ecological aspect, marketing aspect, technical aspect, financial aspect and managerial aspect. Financial institutions including banks appraise a project report for its viability etc., if any financial assistance is desired by the businessman from such institutions. Common errors like over estimations, heavy investment in unproductive assets, wrong projections etc. should be avoided while formulating business plan.

8.9 KEY WORDS

- Cost of capital** : It is the rate of return required by the investors on capital provided by them.
- Cost of project** : It is the total of all items of outlay associated with the project which are supported by long term funds.
- Plant capacity** : Volume/number of units that can be manufactured during a given period.

8.10 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

Planning for the Enterprise

1. i) Guidelines
ii) Ahead
iii) Abandon
iv) Business Plan
v) Pragmatic
2. a) Counselling Organisations
b) State Agencies
3. i) False
ii) True
iii) True
iv) False
v) False

Check Your Progress Exercise 2

1. **Hint:** i) From the business organisation
ii) Analysis of past performance.
2. **Hint:** i) Promoters
ii) Experts in the field of finance, Production etc.
- 3.

| Column I | Column II |
|-------------------------|-------------------------------|
| 1) Market Plan | C) Use of market channel |
| 2) Operation Plan | D) Renovation |
| 3) Financial Plan | A) Projected Income Statement |
| 4) Production | E) Patents |
| 5) Market Research Plan | B) Potential Customers |

Check Your Progress Exercise 3

1. i) False
ii) True
iii) False
iv) False
v) True
2. (*analyse, entrepreneur, expert, financial institutions, feasibility*)

1. i) a) Banker
ii) c) Both of the above
iii) c) Sanction term loan
iv) d) All of the above
v) c) Works on whims and fancies
2. **Hint:** i) Financial viability of the project.
ii) Managerial viability of the project.
3. **Hint:** i) The entrepreneur may make heavy investment in unproductive assets (like land and building) in the initial stages.
ii) The project report may not show enough profits to service its debts and for future development.

8.11 SOME USEFUL BOOKS

1. Desai, Vasant (1998) Dynamics of Entrepreneurial Development of Management; Himalaya Publishing House, Mumbai, Reprint.
2. Nabhi Publication (2004) How to Borrow from a Banking and Financial Institution; Nabhi Publications, New Delhi, Edition.
3. Bidani, Mitra and Promod Kumar (1998) Bank Finance for Industry; Vision Books, New Delhi, Edition.
4. Chandra, Prasanna (1996) Projects, Planning, Analysis, Selection, Implementation and Review; Tata McGraw-Hill Publishing Company Limited, New Delhi, Fifth Reprint.

8.12 ASSIGNMENTS

1. What is a business plan? Why is it needed?
2. What are the features of an ideal business plan?
3. Explain in detail the various inputs required to be mentioned in a business plan.
4. What is a project report? Why is it prepared?
5. "A business plan comprises several elements". Name any two.
6. Mention two points relating to product which should find place in a business plan.
7. What is a market plan?
8. What is the purpose of a projected cash flow statement?

Planning for the Enterprise

9. Explain the various aspects to be covered in a project report.
10. What is the purpose of social cost-benefit analysis?
11. Mention the contents of a project report.
12. What is project appraisal? Who does it?
13. Discuss how the banker will examine technical and financial viability of the project.
14. Mention the various sources of finance which the banker may examine.

UNIT 9 ARRANGING THE INPUTS: FINANCE AND MATERIAL

Structure

- 9.0 Objectives
- 9.1 Introduction
- 9.2 Finance: Meaning, Need and Types
- 9.3 Sources of Finance
- 9.4 Specialised Financial Institution
- 9.5 Evaluation of the Sources of Finance
- 9.6 Material: Its Procurement and Important Considerations
- 9.7 Let Us Sum Up
- 9.8 Key Words
- 9.9 Answers to Check Your Progress Exercises
- 9.10 Some Useful Books
- 9.11 Assignments

9.0 OBJECTIVES

After studying this unit, you should be able to:

- know the meaning and importance of finance;
- understand the various types of capital;
- identify the different sources of finance;
- comprehend the factors involved in selection of appropriate medium of finance; and
- understand the important considerations associated with procurement of material.

9.1 INTRODUCTION

A businessman has innumerable tasks the moment he decides to venture into the line of business. Some tasks out of these may be highly important and crucial for his business to start and gain momentum; while some other tasks may not be so important. The most important task for a businessman is no doubt, to decide 'about what to do'? Should he go into manufacturing line and become a producer or should he divert into a wholesale or retail trade business. Once this important decision is taken then follows the other significant tasks of organizing various resources for his business.

To start with, a businessman needs to assemble five M's i.e. money, material, men, methods and machines for his business. These are the basic inputs required for his business – more so if he plans to be in manufacturing line. In this Unit an attempt has been made to highlight the importance and management of the first two inputs i.e. **money, also known as finance; and material.**

Finance is an important input as no business can function without money and material is important because goods cannot be manufactured without raw material.

9.2 FINANCE: MEANING, NEED AND TYPES

“Finance is the life-blood of any business” – is rightly observed. Finance is required by all types of business – big or small, manufacturing or trading, etc. Finance acts as the lubricant for the wheels of the business to move and to run. No business firm can carry out its work without money. Money is one of the five M’s of business – the other four being men, material, machinery and methods. Provision of finance leads to economic development of the country. Past two decades have shown an increase in setting up of SSIs due to availability of finance on easy and better terms. The amount of finance required may be different from one business to another. It depends upon many factors like nature of the business, size of the business, time-period, etc.

A businessman needs money for the following purposes:

- i) To start a business;
- ii) To expand, renovate and modernize the business.

Types of Capital

Following are two the types of capital required by a businessman:

1. Fixed capital

Fixed capital is required to acquire fixed assets like land, building, plant, machinery, office equipment, furniture and fixtures, erection and installation of machinery, etc. In addition, fixed capital is also required for meeting the cost incurred on insurance, technical know-how etc.

2. Working capital

Working capital is needed to meet day-to-day requirements of a business. For example, amount spent on raw material, wages, hire charges, transportation, interest, etc. It is also known as circulatory capital. Once the raw material is purchased and products are manufactured, the process of selling the goods so manufactured starts. Thereafter, efforts are put in to realise the sale proceeds including that amount of money which gets locked due to the credit sales. The money so realised is once again invested in purchasing raw material and the operating cycle is continued. Hence, the term circulatory capital.

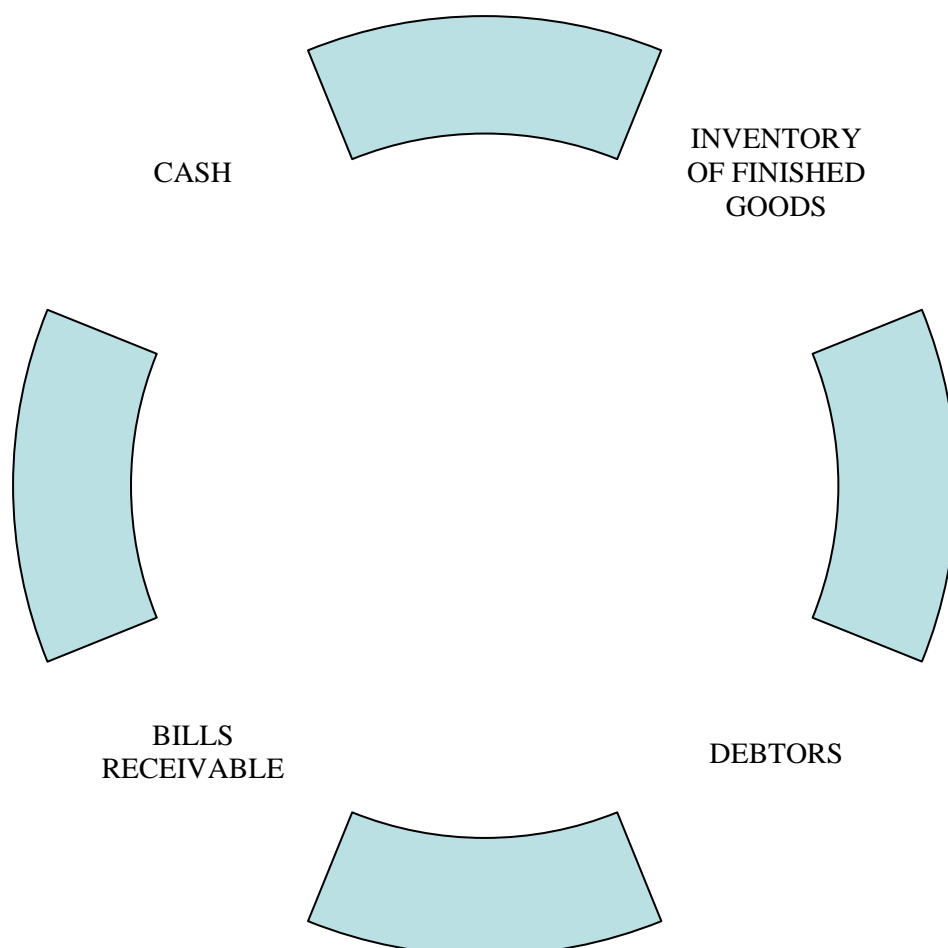


Figure 9.1: Diagrammatic representation of operating cycle in a trading firm selling goods on credit

Types of Finance

For financing fixed capital and working capital a businessman needs long term finance as well as short term finance.

1. Long term finance

Long term finance is used for investment in fixed assets such as land and building, plant and machinery etc. It is used to meet the permanent needs of business. It can be raised through owned capital and long term loans. Such finance cannot be withdrawn from the business.

2. Short term finance

Short term finance is used for investment in working capital. It is used to meet the short term needs of the business. For example, purchase of raw material, payment of wages etc. These funds are normally required for a period ranging from three months to two years.

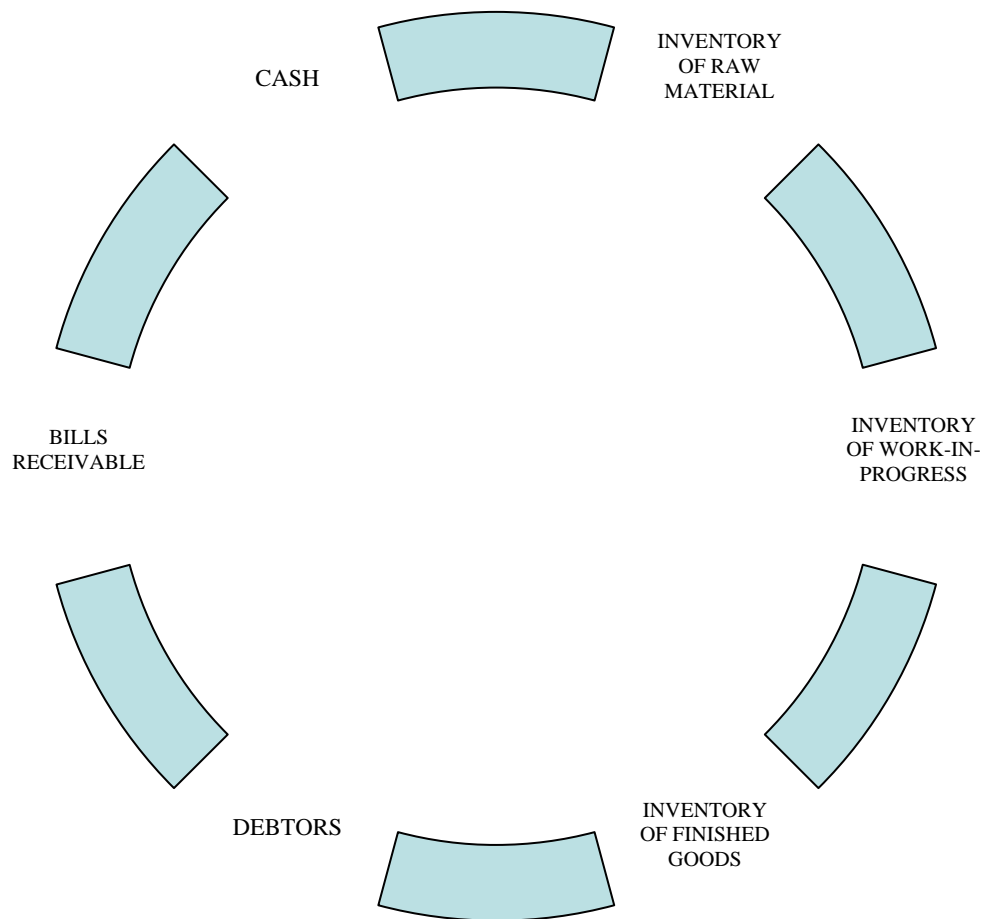


Figure 9.2: Diagrammatic representation of operating cycle in a manufacturing firm selling goods on credit

9.3 SOURCES OF FINANCE

The sources of funds can be broadly divided into:

- i) owned capital; and
- ii) borrowed capital.

Owned capital is the money brought in by the businessman himself, while borrowed capital is the money advanced by outside agencies. However, sources can also be segregated into long term sources and short term sources. These sources are explained below:

Sources for Long Term Finance

1. Owned capital
2. Retained Profits
3. Funds borrowed from friends and relatives.
4. Loans from Commercial banks
5. Loans from National-level Financial Institutions
6. Loans from various State-level Financial Institutions

Let's now discuss the above sources of finance.

1. Owned funds

Owned funds are the funds provided by the owners. In case of a sole proprietor, the individual himself provides the owned funds from his

personal property and past savings. In a partnership firm, the funds contributed by partners as capital are called owned funds. In a joint stock company funds, raised through issue of shares, are known as owned funds.

2. *Retained profits*

The businessman may not withdraw the entire profit from the business. Retained profit represents the amount of profit which remains available in the business after taking out profit for his personal and family affairs. Retained profit serves as a long term source of finance.

3. *Friends and relatives*

Amount can also be collected from the friends and relatives of the businessman. They generally provide this form of assistance at either no or very low rate of interest. The repayment schedule may not be fixed and generally no amount is kept as security. This is provided only due to love and affection.

4. *Loans from commercial banks*

A lot of importance has been put on the role of commercial banks by the successive governments in the development of the economy of our country. It is quite evident that various commercial banks are, therefore, associated with every project of industry/trade irrespective of its size. The banks are catering to the credit needs of a large variety of projects, big or small, in all sectors of the economy including agriculture, trade, industry, services etc. Commercial banks grant term loans for small projects falling under priority sector, small scale sector and also to big units. Long term loans are usually repayable after a period of seven years.

Banks are playing an important role for the upliftment of rural and urban poor. In this direction, they are involved in implementing the various Government sponsored schemes like Swarna Jayanti Gram Swarajgar Yojana (SGSY); Prime Minister's Rojgar Yojana (PMRY); Swarna Jayanti Shahari Rojgar Yojana (SJSRY); Scheme for Liberation and Rehabilitation of Scavengers (SLRS), etc.

5. *Loans from national-level financial institutions*

Various financial institutions play a significant part in development of big industries. Financial Institutions like Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI), Industrial Finance Corporation of India (IFCI), Industrial Investment Bank of India (IIBI), Industrial Credit and Investment Corporation of India (ICICI), Regional Rural Banks (RRBs), National Bank for Agriculture and Rural Development (NABARD) etc. offer financial assistance on long term basis for big projects. These are also known as development financial institutions. They are a major source of finance for forming of new business organisations and expansion of existing concerns. They also provide promotional, technical and managerial services to various new and existing organisations. The rate and repayment procedures are convenient and economical. Loans and guarantees in foreign currency and deferred payment facilities are available for the import of machinery and equipment.

6. *Loans from state-level financial institutions*

State-level financial institutions were established because the National-level financial institutions were providing finance exclusively to large scale industrial units. The Government, therefore, started establishing development banks at the regional level to provide assistance to small scale industries. These institutions provide long term loans to industries for the purchase of land, building and machinery. They also assist in industrial activities like preparation of feasibility report, identifying entrepreneurs, assisting them in project implementation, etc.

Short Term Sources of Finance

Short term finance is required for meeting the short term requirements of business (like working capital). Short term loans are usually repayable within a period of one to three years. The important sources of short term finance are as under:

1. Bank Overdraft
2. Cash Credit
3. Discounting of Bills of Exchange
4. Short term loans
5. Trade Credit from suppliers
6. Accounts Payable
7. Advances from customers
8. Accruals
9. Factoring
10. Co-operative Credit Societies
11. Indigenous Bankers

1. *Bank overdraft*

This is one of the most convenient methods of borrowing. Here, a customer having a current account with a commercial bank like Canara Bank is permitted to withdraw more than what he has deposited. The upper limit of what he can overdraw is fixed. Interest is charged on the amount actually overdrawn during a particular period. Some asset is kept as security. Overdraft limits are usually rolled-over limits which are renewed every year.

2. *Cash credit*

A major part of working capital requirement of any industrial project generally consists of maintenance of inventory of raw material, semi-finished and finished goods, stores and spares etc. Even in trading concerns funds are required to maintain stock-in-trade. Finance against such inventory is granted in the shape of cash credit facility where cash withdrawals are permitted against stock of goods. A running account facility is provided where deposits and withdrawals are permitted to the borrower as frequently as required. Over-drawls are however restricted to an agreed limit and are further subject to availability of drawing power in the account.

3. *Discounting of bills of exchange*

Commercial banks also extend financial assistance by discounting bills of exchange. Here the customer i.e. the businessman can get the amount of a

bill receivable from the bank before the date of maturity. Charges have to be paid by the customer known as discounting charges.

4. *Short term loans*

Loans provided by commercial banks are repayable in monthly/quarterly/half-yearly/yearly instalments. Commercial banks grant short term loans and medium term loans for working capital requirements. Short term loans are repayable in less than three years while medium term loans are repayable in a period ranging from three years to seven years. A loan is granted against security of assets and the personal guarantee of the borrower. Collateral security is also demanded as and when necessary. Interest on loans is required to be paid on regular basis irrespective of the loss suffered by the borrower.

5. *Trade credit from suppliers*

Trade credit is the credit extended by the seller of goods to the buyer as incidental to sale. It is available in the ordinary course of business without any security. An open account credit arrangement is made, the volume of which depends upon the reputation of the buyer, financial position of the seller, volume of purchase etc.

6. *Accounts payable*

Accounts payable is another form of trade credit. Here, the buyer is required to sign a debt instrument e.g. a bill of exchange or a promissory note as an evidence of the amount due by him to the seller. This credit is also made available without creating any charge on assets.

7. *Accrual accounts*

There is usually a time-lag between receipt of income and making payment for the expenditure incurred in earning that income. During this time-lag the outstanding expenditure helps an enterprise in meeting some of its working capital requirement. For example, wages and salaries, taxes due but not paid immediately etc. Wages and salaries are paid in the first week of the month next to the month in which services were rendered.

8. *Advances from customers*

If the businessman is manufacturing a product which is in short supply, he may demand advance money from his customers at the time of accepting their orders. This is a very cheap source of short term finance because either no interest is payable or the rate of interest payable on advance is nominal.

9. *Factoring*

The businessman can obtain short-term finance through factoring. It is an arrangement under which the businessman assigns his book debts to the factoring firm. Against such assignment of debtors' balances the banker advances the money to the businessman. For providing the services of factoring, the factoring firm charges commission known as 'commercial charge'. SBI has opened a subsidiary by the name SBI Factors and Commercial Services Ltd. which provides factoring services. Similarly, Canara Bank has also opened a subsidiary by the name Canara Bank

Factors Ltd. for the purpose of providing factoring services in India. SIDBI has also introduced its own factoring services.

10. Co-operative credit societies

Co-operative Credit Societies are formed by artisans, agriculturists, industrial workers etc. These societies provide financial assistance at reasonably low rate of interest to its members. They also promote the habit of saving and thrift among them.

11. Indigenous bankers

Businessmen can get loans from various indigenous bankers as well. They are known by different names like shroffs, seths, sahkars, mahajans, etc. in different parts of the country. They vary in size from petty money-lenders to substantial shroffs who carry on large and specialized business. They finance the businessmen by means of hundies or bills of exchange. They lend against personal credit of the borrowers. The rate of interest is usually very high. They may not give receipts in most of the cases.



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Name the source of finance in the following cases:

i) Rakesh received Rs. 1,00,000 from his grand parents to start his business.

.....

ii) Shri Ganesh, a neighbour of Mukesh agrees to give Rs. 5,000 to him without any interest.

.....

iii) Suhail Khanna borrows Rs. 25,000 @ 5% p.a. from his brother-in-law.

.....

iv) M/s. Utkarsh & Sons took loan of Rs. 1,00,000 from Canara Bank repayable in three years.

.....

v) Kishore starts his business investing Rs. 50,000 in cash.

.....

2. Classify the following expenses into fixed capital and working capital:

i) Purchase of raw material.

.....

ii) Purchase of plant & machinery.

.....

iii) Purchase of land and building.

.....

iv) Rent paid.

.....

v) Purchase of 'Maruti 800'.

.....

3. Name the sources of finance in the following cases:

i) A source of finance where credit is extended by the seller of the goods.

.....

ii) A source of finance where expenses are paid in the first week of the month next to the month in which services were rendered.

.....

iii) A source of finance where 'sahukars' or 'mahajans' grant credit to the business.

.....

iv) A source of finance provided by commercial banks where a customer can withdraw more money than he has deposited.

.....

v) A source of finance where the business can get the amount of a bill receivable from the bank before the date of maturity.

.....

9.4 SPECIALISED FINANCIAL INSTITUTIONS

Specialised financial institutions mainly provide long term financial assistance in various forms. Besides sanctioning loans, they give guarantees for loan raised by the business concerns from other sources.

These institutions are also known as development banks because they provide not only capital but also knowledge and entrepreneurship to the industry. These institutions undertake potential industrial surveys; identify growth projects; provide technical, managerial and other assistance to the entrepreneurs.

These special financial institutions, both at National-level and State-level have been set up upon the initiative of the Central and State Governments respectively.

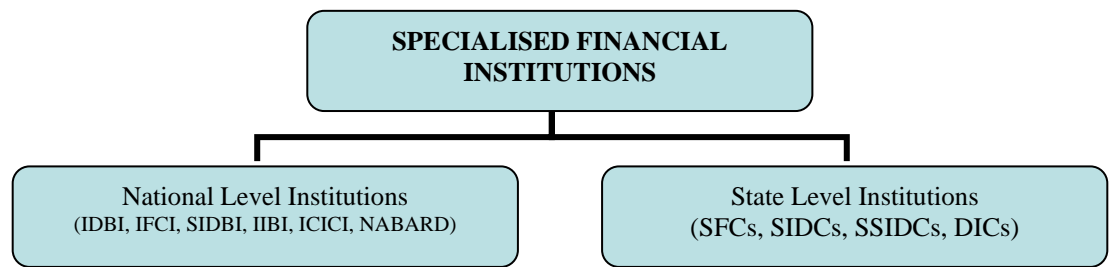


Figure 9.3: Diagrammatic representation of types of specialised financial institutions

Let's now discuss some of the important specialised financial institutions.

1. Industrial Development Bank of India (IDBI)

IDBI was set up as a wholly owned subsidiary of Reserve Bank of India in July, 1964 by an Act of Parliament. It serves as an apex level national institution for providing term finance to the industry. In 1976, the ownership of IDBI was transferred to the Government and it was entrusted with the additional responsibility of acting as principal financial institution for coordinating the activities of institutions engaged in the financing, promotion or development of industry.

Functions of IDBI

- i) It provides direct financial assistance to industrial concerns by giving them long term loans.
- ii) It provides technical and administrative assistance for promotion and expansion of industry.
- iii) It guarantees loans raised by industrial concerns from other financial institutions.
- iv) It accepts bills of exchange of industrial concerns and also discounts and rediscounts them.
- v) It provides refinancing facilities.

2. Small Industries Development Bank of India (SIDBI)

SIDBI was set up by an Act of Parliament i.e. Small Industries Development Bank of India Act, 1989 as a wholly-owned subsidiary of IDBI for re-financing, bills rediscounting, and equity support to the small scale sector. It started functioning on April 2, 1990. SIDBI was de-linked from IDBI w.e.f. 27th March, 2000. It serves as an apex level national institution for promotion, finance and development of industries in the small sector.

Functions of SIDBI

- i) It provides financial assistance through term loans and working capital.
- ii) It provides finance through discounting and re-discounting of bills arising from the sale of machinery to small units.
- iii) It provides Venture Capital support.
- iv) It provides services like factoring, leasing etc.

3. National Bank for Agriculture and Rural Development (NABARD)

NABARD has been set up for the promotion of agriculture, small scale industries, cottage and village industries, handicrafts etc. in the rural sector. It is an apex bank for agricultural finance. It came into existence on July 12, 1982. It provides refinancing facilities. It has initiated Micro Finance programme under which millions of poor people have been provided access to credit. It has created special funds like Watershed Development Fund, Tribal Development Fund, Research and Development Fund, Farm Innovations Fund, and Micro Finance Development and Equity Fund to support innovations in neglected areas.

4. Regional Rural Banks (RRBs)

The object of setting up Regional Rural Banks was to bring the banking services to the doorsteps of rural masses. Initially these banks were providing funds to target groups comprising weaker sections of the society at a concessional rate of interest. However, since 1997 the RRBs have been allowed to lend outside the target group also by classifying their advances into priority sector and non-priority sector.

5. State Financial Corporations (SFCs)

A special law known as State Financial Corporation Act, 1951 was passed by the Parliament to enable all the states except Jammu and Kashmir to set up their own State Financial Corporations. So far 18 SFCs are operating in different States and Union Territories.

The main objective of SFCs is to finance and promote small and medium enterprises and projects costing up to Rs.5 crores for achieving balanced regional socio-economic growth and generating employment opportunities. SFCs operate a number of schemes of refinance and equity type of assistance formulated by IDBI, SIDBI which include schemes for artisans, SC/ST, women, ex- serviceman, physically handicapped etc. and for transport operators, for setting up hotels, hospitals etc.

SFCs can provide financial assistance to proprietary concerns and partnership firms up to Rs. 120 lacs.

Functions of State Financial Corporations

Following are the functions of SFCs:

- i) They provide term loans for acquiring land, building, plant and machinery, other miscellaneous fixed assets etc.
- ii) They establish polytechnics or training institutes for imparting training to technically qualified persons.
- iii) They take up the development of lesser developed parts of the State and engage in infrastructure development like electricity, road, water etc.
- iv) They promote self-employment.
- v) They provide finance for expansion, modernization and up-gradation of technology in the existing units.
- vi) They identify and examine local problems.

- vii) They provide seed capital assistance under the schemes of IDBI.
- viii) They provide deferred payment guarantees for purchasing plant and machinery.
- ix) They provide foreign exchange loans to industrial units under World Bank Schemes.

General Terms and Conditions of Financial Assistance to Small Scale Units provided by SFCs

The general terms and conditions of financial assistance which may be provided to the small scale units are as follows:

1. *Quantum of assistance:* No minimum or maximum quantum of assistance has been stipulated except the upper ceilings.
2. *Debt-equity ratio:* SFCs may approve a Debt-Equity ratio of up to 2.5:1 for providing assistance.
3. *Promoters' contribution:* A minimum promoters' contribution ranging from 12.5% to 22.5% depending upon the location of project and category of enterprise may be accepted.
4. *Repayment period:* SFCs usually fix the repayment period after taking into consideration the profitability and debt servicing capacity of the project. No repayment period is fixed beyond 10 years.
5. *Rate of interest:* The rates are subject to revision from time to time.
6. *Commitment charges:* The commitment charges are payable only after the expiry of 12 months from the date of sanction. However, the rates may again vary from state to state. Usual Commitment Charges are as under:

| | |
|-----------------------------------|----------------|
| <i>For loans up to Rs.5 lacs:</i> | <i>NIL</i> |
| <i>For other Projects:</i> | <i>1% p.a.</i> |

Composite Loan Scheme of SFCs

Generally, SFCs provide assistance for term loan component and the unit has to arrange working capital requirements from a commercial bank of its own choice. SFCs, however, operate a composite loan scheme which meets all the requirements of the unit. Composite loans up to Rs. 50,000 are sanctioned under the Scheme to artisans, village and cottage industries and SSI units in tiny sector. The repayment period of such composite loans is spread from 3 years to 7 years.

Seed Capital Assistance provided by SFCs under the Scheme of IDBI

Under this Scheme maximum assistance per unit is restricted to Rs. 15 lacs. The following categories of entrepreneurs are generally eligible for assistance:

- i) Entrepreneurs establishing small scale units for the first time.
- ii) Entrepreneurs wishing to undertake expansion, diversification or modernization of small scale units and yet remaining small scale units.

- iii) Entrepreneurs wishing to set up a medium scale unit for the first time or wishing to undertake expansion, diversification of existing industrial undertakings for better viability.
- iv) Entrepreneurs taking over an existing sick or closed industrial unit.

Application under the Scheme may be made simultaneously along with the main loan application for project finance. The assistance is granted free of interest and a nominal service charge of 1% p.a. is levied on the amount outstanding under the assistance.

6. State Industrial Development Corporations (SIDCs)

SIDCs were set up in 1960s and 1970s. These were established as wholly-owned undertakings of the State Governments under the Companies Act, 1956 or autonomous corporations under specific State Acts. Different States have set up the State Industrial Development Corporations with a view to improving the growth of industry in their States. These corporations operate as per the Guidelines issued by State Governments. There are 28 SIDCs operating in our country. They provide assistance to small and medium units and projects costing up to Rs. 10 crores.

Functions of SIDCs

- i) They promote and develop industries by activities like project identification, preparation of project report, selection and training of entrepreneurs.
- ii) They provide term loans to industries.
- iii) They grant incentives and subsidies on behalf of the Central and State Governments.
- iv) They act as agent of IDBI, SIDBI and thereby provide the benefit of seed capital scheme.
- v) They provide risk capital to entrepreneurs by way of equity participation.
- vi) They develop industrial area by providing infrastructural facilities.

7. State Small Industries Development Corporations (SSIDCs)

SSIDCs are State Government undertakings responsible for catering to the needs of the small, tiny and cottage industries in the States/Union Territories. They undertake a variety of activities for development of the small sector. At present, there are 18 SSIDCs in operation.

Functions of SSIDCs

- i) They extend seed capital assistance on behalf of the State Government.
- ii) They procure and distribute scarce raw material.
- iii) They provide machinery on hire-purchase basis.
- iv) They provide assistance for marketing of the products of small scale units.
- v) They provide managerial assistance to production units.

8. District Industries Centres (DICs)

DICs have been established in every district. The objective of establishing such centres is to develop small and village industries. They collect information about the availability of raw material and make arrangements for machinery and equipment, marketing research, credit facilities etc. for the development of small units in the district. They identify the potential borrowers in the small sector and sponsor their loan applications to the banks operating in the district. Under the Prime Minister’s Rozgar Yojna Scheme (PMRY), DICs are assigned the task of identification of beneficiaries and implementation of the Scheme in the district.



Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Write the full forms of the following Institutions:

i) IDBI

.....

ii) SIDBI

.....

iii) NABARD

.....

iv) SFC

.....

2. Match the following:

| Column I | Column II |
|-----------|--|
| 1. SFC | A) Apex level national institution in small sector |
| 2. SIDCs | B) Delhi Financial Corporation |
| 3. SSIDCs | C) Identification of borrowers in a district |
| 4. SIDBI | D) Small, tiny and cottage industries |
| 5. DICs | E) Twenty Eight |

9.5 EVALUATION OF THE SOURCES OF FINANCE

The sources of finance as discussed above can be broadly divided into owned capital and borrowed capital. Both the sources have their own advantages and disadvantages. Even, for availing of borrowed capital the businessman may have to evaluate among the various available options and choose.

Advantages of Owned Capital

- i) *Supply of long term capital:* The businessman obtains funds on long term basis. Owned capital provides long term investment.
- ii) *Control:* The businessman maintains full control over his business. He has full rights to take decisions without interference from any outside person. Thus, he commands control over his business.
- iii) *No charge on assets:* The businessman is not required to keep his assets as security with any institution so long his own capital is used in the business. Consequently, he can offer the assets of the firm to other agencies for raising loan in case he is in need of additional capital besides his own.
- iv) *No repayment of liability:* Owned capital is not required to be returned to any body as in the case of loan which is required to be repaid over a period of time.
- v) *No fixed cost:* Owned capital does not carry any fixed rate of return as in the case of a loan where interest is required to be paid on periodical basis.

Disadvantages of Owned Capital

- i) *Investment of the personal savings:* In case a businessman has invested his own money in the business, a large chunk of his personal savings goes away. Therefore, not much is left for his rainy days.
- ii) *Limited scope of expansion:* With his owned capital invested in the business, a businessman has limited scope of expansion. This is so because he can commit his own resources to a certain extent and beyond that he will have to borrow from outside sources.
- iii) *Danger of over-capitalisation:* Use of owned capital may lead, at times, to over-capitalisation. This is so because the businessman is free to invest as much capital as he can. At times, the capital invested is more without being put to productive use. In that case the rate of earning is less in comparison to the capital invested.

Advantages of Borrowed Capital

- i) *Availability of funds:* The businessman obtains the funds which are not available through owned capital.
- ii) *Long term source:* Outside funds such as long term loans from banks serve as the source for investing in fixed assets.
- iii) *Scope for expansion:* A businessman can think of expanding his business because with the help of borrowed money further resources are available which can be used in modernization and diversification of the business.
- iv) *Tax Benefit:* Interest paid on borrowed capital is an expenditure which is deducted from the profits liable to income tax. The loans thus provide tax benefit to the businessman.
- v) *Non-interference in the management:* The banks generally do not interfere in the management of the business.

Disadvantages of Borrowed Capital

- i) *Financial burden:* The businessman is required to pay the interest on the loan regularly at a fixed rate. This results in the creation of financial burden if the enterprise is running at a loss.
- ii) *Charge on assets:* The loans are generally secured by pledging the assets as security. Owing to the pledging the assets do not remain free.
- iii) *Borrowing capacity:* Ideal debt-equity ratio is 2:1. Excessive borrowing reduces capacity to borrow and therefore the businessman is unable to borrow after a certain limit.

Factors Affecting the Choice of the Source of Loan

Following are the factors which should be evaluated while making a choice about the source of availing loan:

- i) *Rate of interest:* Interest is an expense for the firm to be paid on regular basis whether the business earns profit or not. This reduces the profits of the firm. Therefore, the businessman should enquire as to which financial institution is charging the lowest rate of interest before taking a decision to avail of loan from a particular institution. He should opt for that source only where the interest burden is the lowest.
- ii) *Repayment period:* The businessman should evaluate the various sources of loan from the point of view of repayment terms. The banker/institution who provides longer repayment period for the similar loan should be preferred.
- iii) *Margin requirement:* Every lender insists upon minimum contribution as margin from the side of businessman. However, margin requirement may differ from bank to bank. Thus, a businessman should negotiate the loan proceedings with the bank which offers lower margin requirements.
- iv) *Processing charges:* Every financial institution imposes some charges for processing the loan proposal, known as processing charges. It is also one of the factors which should be considered while evaluating a loan. Lower processing charges should be preferred. At the same time, it should be seen that there is no hidden cost involved in a particular loan proposal.
- v) *Time-period involved in sanctioning the loan:* The banker who takes lesser time in sanctioning and disbursing the loan should be preferred. In the case of some banks even branch managers are empowered to sanction loans whereas in the case of others, the sanction comes from the higher authority. It is but natural that the branch manager, if empowered, can sanction loan at the earliest whereas if the sanctioning authority is other than the branch manager, the sanction will take much longer time.

9.6 MATERIAL: ITS PROCUREMENT AND IMPORTANT CONSIDERATIONS

Material is one of the five M's of business. With the help of raw material a product can be developed. After the product is sold in the market generation of revenue starts. It is pertinent to note that raw material is the first element in the cost of the product. A proper control over the material is a must right from its

procurement till it is consumed in developing the product. In the following paragraphs important aspects relating to materials are discussed.

Principles of Purchasing

Material is procured through the process of purchasing. Therefore, a proper control over purchasing is necessary. Following points, known as five R's of best buy, are the main principles of purchasing material:

1. Right Source
2. Right Quantity
3. Right Quality
4. Right Price
5. Right Time

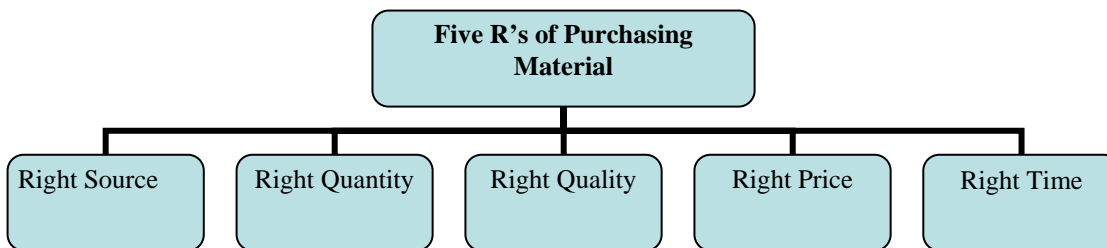


Figure 9.4: Diagrammatic representation of five R's of purchasing material fog

Let's now discuss the five R's in detail.

1. Right source

Right source of procuring raw materials indicates the suppliers/sellers from whom the material can be procured. If the source of procuring material is right we can hope to procure material of right quality in right quantity at right price and at right time. In other words, if there is right source the access to other R's of best buy can easily be made. The following points should be kept in mind while making a choice for the right source:

- i) *Location of the supplier:* The businessman should see that the supplier is preferably located near his business site so that heavy spending on transportation is avoided. In fact, geographical location of the supplier has a lot of bearing on the procurement of material.
- ii) *Financial position of the supplier:* The businessman should keep in mind that the financial position of the supplier is sound. If the supplier is of sound financial position, he will keep the material always in stock otherwise he may always demand advance payment as and when the order is placed and supply the material after a gap of certain period. In other words, ready supply may be a problem.
- iii) *Terms of Supply:* The businessman should procure the material at terms which are beneficial to him. Thus, the ideal supplier will be the one who offers the best terms of supply.
- iv) *Production facilities at supplier's end:* In case the supplier is producing the material whether production facilities at his end are capable enough to produce material as and when demanded. The businessman has to keep this aspect also in mind, while making a choice of the right supplier.

2. *Right quantity*

Procurement of material in right quantity is another consideration to be kept in mind by the businessman. Right quantity of material to be purchased shall depend upon the (i) raw material required for the production during the year; (ii) time required in getting the supply of the material; and (iii) the quantity of material which the businessman can carry at a particular point of time i.e. average material required. The businessman shall have to decide as to how many orders should be placed in a year so that per order cost is the minimum. Bulk quantity can be purchased at a discount but in that case, the amount of capital invested in bulk purchase shall be more and at the same time the storing cost of the material shall also be more. Thus, a right balance is to be maintained and optimum quantity is to be purchased.

3. *Right quality*

Right quality of the material indicates that it will suit the requirements of the product. Quality will relate to the size, shape, appearance, colour, strength etc. of the material. According to the product to be produced, the businessman should decide the right quality of the material.

4. *Right price*

Right price of the material indicates that qualitative material is available in right quantity at that price. Right price may not be the lowest one but it should be as near to the lowest side as possible. Right price also means that the supply is available without delay, reasonable services are provided by the supplier and transportation cost in getting the material delivered at the door-steps of the businessman is the minimum. It may happen that though the price of the material is very low but transportation cost of bringing the material to the site is very high. Thus, the overall cost to be incurred is much higher than the cost at which the material is available locally. In this case local price is the right price.

5. *Right time*

Material should be available to the businessman at the right time. It means whenever the material reaches the re-order level, the supply should be available before there is stock-out. Further, supply should be available without keeping excessive stock. In other words, right time of purchasing indicates that there is no problem relating to piling up of stock or because of shortage of stock the production is to be stopped for some time.

Purchase Procedure

The job of purchasing material should be done by Purchasing Department under the supervision of Purchase Manager if the size of the concern allows. Purchasing of material involves a series of steps. Let's now discuss these steps one by one.

1. *Purchase requisition*

The purchase process begins with the receipt of a purchase requisition by the purchasing department. The requisition contains particulars regarding quantity, quality, date by which the purchase of material is required etc. A specimen of purchase requisition form is given below (Table 9.1):

Table 9.1: Specimen of purchase requisition

| <p>ABC Bros.</p> <p>Address:-----</p> <p>Purchase Requisition</p> <p>No. Date-----</p> <p>Please arrange to purchase the following items by -----2005</p> | | | | | |
|---|--------------------------|----------------------------|---------------|----------------|----------------------|
| Code no. of the article | Quantity to be purchased | Description of the article | Stock in hand | Previous order | |
| | | | | No. with date | Name of the supplier |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| <p>Signature-----</p> <p>(Name of the authorised signatory)</p> <p>Designation</p> | | | | | |

2. Inviting quotations

After receiving the purchase requisition, the purchase department contacts the various suppliers and invites quotations from them. A quotation indicates the price, quantity, quality and other terms and conditions of purchase.

3. Purchase order

The purchase department will scrutinize the quotations received from various suppliers. The person who is willing to supply the material of right quality at the right price should be preferred. A purchase order will then be prepared authorizing the supplier to supply the quality material at the agreed terms and conditions (Table 9.2)

Table 9.2: Specimen of purchase order

| <p>ABC Bros. Address:-----</p> <p style="text-align: center;">Purchase Order</p> <p>No. Date-----</p> <p>Please arrange to supply the following items by -----2005 as per the agreed terms and conditions stated overleaf:</p> | | | | | |
|---|----------------------------|----------|------------------------|-----------------|---------|
| S. No. | Description of the article | Quantity | Rate per item (in Rs.) | Amount (in Rs.) | Remarks |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| <p>Signature----- (Name of the authorised signatory) Designation</p> | | | | | |

4. Receiving of material

The Receiving Department will now receive the goods, unpack them and verify the contents of the packages with the consignment notes sent by the supplier. Discrepancies, if any, are then brought to the notice of the supplier for taking corrective action.

5. Initiating payment

The copies of purchase requisition, purchase order, invoice etc. are sent to the Accounts Department. This Department checks the calculations etc. and thereafter, issues a cheque to the supplier towards payment.



Check Your Progress Exercise 3

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Mr. Gupta, Manager of Receiving Department, on examination finds that out of 100 containers of mustard oil supplied by M/s. Nagpal & Co., five are leaking. Write the appropriate action to be taken by him.

.....

2. Arrange the following steps of procuring material in proper sequence:

- i) Inviting quotations
- ii) Receiving purchase requisition
- iii) Initiating payment
- iv) Placing purchase order
- v) Receiving of material

9.7 LET US SUM UP



Once the businessman decides as to which line of business he should enter into, the next significant task for him is to organize various resources for his business. Besides other resources, he has to arrange for finance and material. Finance is needed to start a business and to expand, renovate and modernize it. A businessman needs both fixed capital (for purchasing fixed assets) and working capital (for meeting day to day financial requirements of business). Long term finance can be obtained through owned capital and retained profits ploughed back in the business. Further, funds can also be borrowed from friends and relatives and loans can be obtained from Commercial banks, National-level Financial Institutions and various State-level Financial Institutions as well. Short term finance can be obtained through various sources like bank overdraft, cash credit, discounting of bills of exchange, short term loans, trade credit from suppliers, assistance from Co-operative Credit Societies etc. There are certain specialized financial institutions like IDBI, SIDBI, NABARD, various SFCs, SIDCs, DICs which are involved in providing loans to the industries at attractive terms and conditions. A businessman should thoroughly evaluate the various sources of finance before committing funds in the business. Material is needed to develop a product. A businessman has to apply the five R's of the best buy. For procuring material, the businessman should develop and follow the right kind of purchase procedure.

9.8 KEY WORDS

- Collateral security** : Secondary security demanded for sanctioning loan, in addition to the primary security.
- Preliminary expenses** : Expenses incurred by a company before its formation.
- Commitment charges** : Charges levied by the bank for not using the sanctioned limit.
- Debt-equity ratio** : A ratio which establishes relationship between debt and equity. Normally, loan equivalent to double the equity can be raised.
- Deferred payment guarantee** : A kind of guarantee given by a financial institution to the supplier of fixed assets like machinery that the payment of instalments shall be made on due dates.



9.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

1.
 - i) Owned funds
 - ii) Friends and relatives
 - iii) Friends and relatives
 - iv) Commercial banks
 - v) Owned funds
2.
 - i) Working capital
 - ii) Fixed capital
 - iii) Fixed capital
 - iv) Working capital
 - v) Fixed capital
3.
 - i) Trade credit
 - ii) Accrual account
 - iii) Indigenous banker
 - iv) Overdraft
 - v) Discounting of bill of exchange

Check Your Progress Exercise 2

1.
 - i) Industrial Development Bank of India
 - ii) Small Industries Development Bank of India
 - iii) National Bank for Agriculture and Rural Development
 - iv) State Financial Corporation
- 2.

| Column I | Column II |
|-----------|--|
| 1. SFC | B) Delhi Financial Corporation |
| 2. SIDCs | E) Twenty Eight |
| 3. SSIDCs | D) Small, tiny and cottage industries |
| 4. SIDBI | A) Apex level national institution in small sector |
| 5. DICs | C) Identification of borrowers in a district |

Check Your Progress Exercise 3

1. **Hint:**
 - i) Immediately after examination, informing the supplier (i.e. M/s. Nagpal & Co.) about the leakage of five containers.
 - ii) Not to pass the bill for payment till the satisfactory action is taken by the supplier.
2.
 - i) Receiving purchase requisition
 - ii) Inviting quotations
 - iii) Placing purchase Order
 - iv) Receiving of material
 - v) Initiating payment

9.10 SOME USEFUL BOOKS

1. Desai, Vasant (1998) Dynamics of Entrepreneurial Development of Management; Himalaya Publishing House, Mumbai.
2. Gupta, C.B. and Khanka, S.S. (2004) Entrepreneurship and Small Business Management; Sultan Chand and Sons, New Delhi; Fourth Ed. Reprint.
3. Maheshwari & Mittal (2002) Cost Accounting, Theory and Problems; Shri Mahavir Book Depot, New Delhi, Twentieth Ed.
4. Mitra, Bidani and Kumar, Promod (1998) Bank Finance for Industry; Vision Books, New Delhi.
5. Nabhi Publication (2004) How to Borrow from a Banking and Financial Institution; Nabhi Publications, New Delhi.

9.11 ASSIGNMENTS

1. Kotak Enterprises wants Rs. Ten lakhs to invest in stock. Under which type of capital his loan application shall be considered by the bank.
2. Explain the various short term sources of finance.
3. Explain the various long term sources of finance.
4. “Working capital is needed because of the existence of operating cycle.”
Comment.
5. Mention the various functions of State Financial Corporations.
6. How do the commercial banks contribute towards the development of an economy.
7. Should the indigenous bankers be eliminated altogether? If yes, then why are they still existing in our society.
8. Write correctly the following Government sponsored schemes:
 - i) Swarna Jayanti Gram Swapan Yojana
 - ii) Prime Minister’s Rojana Yojana
 - iii) Swarna Jayanti Shatabdi Rojgar Yojana
9. M/s. Kohinoor Bros. are interested in purchasing 500 Kgs. of sugar. Explain the purchase procedure which shall be followed by them.
10. Purchase requisition is a first step of purchasing raw material. Mention the remaining steps of procuring the material.
11. Complete the following Specimen of Purchase Requisition Form of Vikalp & Co.

| | | | | | |
|---|--|--|--|--|--|
| <p>Vikalp & Co. Address:-----</p> <p>Purchase Requisition</p> | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| <p>Signature----- (Name of the authorised signatory) Designation</p> | | | | | |

12. Complete the following operating cycle by filling the correct words:

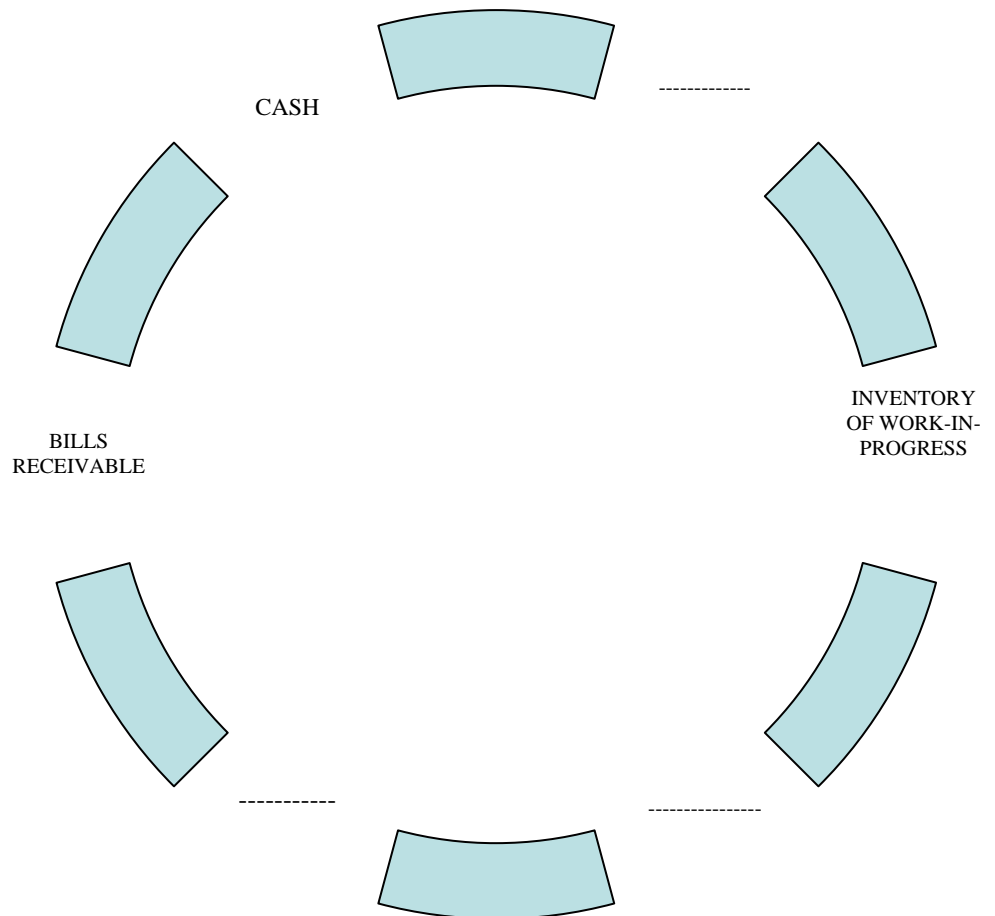


Figure 9.5:

UNIT 11 PRODUCT CONSIDERATION

Structure

- 11.0 Objectives
- 11.1 Introduction
- 11.2 Product: Meaning and Significance
- 11.3 Product Selection
- 11.4 Product Mix Decisions
- 11.5 The Concept of Product Lifecycle
- 11.6 Branding and Packaging Decisions
- 11.7 Differentiation and Positioning Products
- 11.8 Let Us Sum Up
- 11.9 Answers to Check Your Progress Exercises
- 11.10 Some Useful Books

11.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the concept of a product and its significance for an enterprise;
- identify criteria that can be used in the selecting a suitable product for your enterprise;
- select appropriate value added food products for your enterprise;
- discuss the concept of product mix and apply the same to your enterprise;
- explain how products go through a life cycle of development;
- explain the significance of branding and packaging for value added products;
- select a suitable brand name and an appropriate packaging for your value added food products; and
- identify suitable positioning alternatives for your products.

11.1 INTRODUCTION

Products are the most tangible outcome of an enterprise engaged in manufacturing. They represent the value that manufacturers create and offer to the market for consumption and usage. Product decisions are important decisions for any enterprise because they determine the line of business an enterprise has chosen for itself. This unit introduces the concept of a product and its significance to an enterprise. It also familiarizes you with related terms like the product mix, the product line and product augmentation. Selection of a suitable product line is often a major determinant of the success of an enterprise. The unit also discusses the various criteria that you should use to select appropriate value added food products for your enterprise. Like living organisms, products also go through a life cycle of introduction, growth maturity and decline which need to be managed by the entrepreneur. The Among The decisions that you have to take regarding your product are branding and packaging decisions. The unit discusses the basic inputs that must be borne in mind while considering the branding and packaging alternatives for the value added food products.

11.2 PRODUCT: MEANING AND SIGNIFICANCE

A product is anything that is offered to the market for sale and consumption and has got the potential to satisfy a consumer need or a want. Consumers buy products to satisfy their needs or wants. It is therefore, important for you to think of the product as a solution to the consumer's problem of satisfying his food related needs. When a consumer buys soap, he is looking for a solution to his need for cleanliness and personal hygiene. In addition, he may also be looking for a solution to his problem of dry skin. Among the products available in the market, those that can provide the benefits of cleaning without drying up the skin will have the greatest potential for being selected by the consumer because the consumer perceives such a product as being an ideal solution to his need to stay clean without having a dry, scaly skin. Similarly, when a mother buys a snack for a child; she is looking for the solution to her need for both safety and nutrition for her child. Only a product which provides the benefits of both nutrition and some guarantee of being a safe food product will have the potential of being selected by the mother. A product therefore, represents a bundle of benefits or attributes, which enable it to address a given customer need or want. To conceptualize a product for your enterprise, you will first have to define the need of the consumer that this product is expected to satisfy, and then identify the benefits that a given set of consumers may look for in a value added food product. Such an understanding will help you to focus on the need of the consumer as the starting point for your product idea and product concept. This understanding is important because it enables you to think of a product essentially as a solution to the consumer needs, and therefore must at all times be responsive to the changing needs and requirements of the consumer.

Activity 1

Try to identify the consumer needs that the value added food products may cater to. You may like to do this for the following categories of products

- A. Jams, jellies and marmalade
- B. Pickles and preserves
- C. Branded spice mixes

Ask the existing consumers the reasons for their purchase of these products. In each case describe the needs that were mentioned by these consumers.

- A.
- B.
- C.

(Hint: You would find that most people mention reasons like taste and flavour in the first case while adding variety and spice to every day menu may be mentioned as reasons in the second case – All these answers give you an idea as to how new taste combinations and flavours you can actually visualize as new product ideas for the value added food products from fruits and vegetables).

You must have now understood that any given product is actually a bundle of potential benefits that you can offer to a consumer in respect of a given need. These benefits accrue to the consumer as a result of the product attributes which may be physical or psychological in nature. The physical attributes include the product ingredients, its colour, taste flavour, size, weight etc, while the psychological attributes may relate to the brand image and brand positioning in the consumer's mind.

Product classifications also help us understand how consumers behave in relation to different product classes. You may then try to identify in which class you would like to place your value added food product so that you have a general idea of what to expect from the consumers when they consider your product for purchase. Broadly, all products can be classified as consumer products and industrial products. Consumer products are those that are bought and used by ultimate consumers and in such a form that they can be used without much further processing. Industrial products, on the other hand are bought for use in manufacturing other goods or producing some services. Consumer products are further subdivided as:

Convenience goods: These are consumer goods which are frequently purchased and are bought by the consumer without making much effort in making the purchase decision or the act of buying. The consumer often has a brand in mind before he purchases the product as these are the products he may have bought many times over in the past. Common examples include newspapers, household products of daily consumption like tea, coffee, food products like breakfast cereal etc.

Shopping goods: These products are purchased after comparing the products on offer by different manufacturers and retailers. While the consumer has a general idea of what he wants he would like to compare the items on offer in the same product category before deciding what to buy. Common examples of this category are apparel, shoes, furniture etc.

Specialty goods: These are infrequently bought products and bought for their special characteristics and features, with a great degree of buying involvement. The consumer knowledge prior to product search is not very high and the purchase is characterized by fairly intensive consultation with other users and/or dealers. Examples include cars, audio visual systems, residential homes etc.

Consumer durables: These are the products which survive several uses and have a relatively long life. Examples would be products like refrigerators, fans, radio sets etc.

You would, by now, have an idea where the product category of value added food products would fit in as a product class. Being relatively perishable products, value added food products would be in the category of non-durable, speciality or shopping goods which may not relate to a basic necessity but are either part of established food habits of consumers or are bought to add special interest, variety or taste enhancement to basic fare.

11.3 PRODUCT SELECTION

Selection of an appropriate product category for your enterprise would require you to answer these basic questions:

- What is the need this product relates to?
- How is the need being presently satisfied? Are there any gaps in need fulfilment or unfilled demand that can be satisfied by your entering the market with this product? In other words, is there a need in the existing market for the value added food product that you are contemplating?
- What is the type of value that is being offered by your competitors? In what way is your proposed product likely to be different or give the consumer a reason to buy?
- Do you have the necessary skills or competency to produce the product?
- Are the raw materials for your value added food products easily accessible and available?
- What's the potential size of the market for the product; in the area in which you want to operate?
- Are special implements or machinery required for the production process of these products? Do you have the resources or the access to these implements / machinery?
- In what way is the proposed product unique or different from others in the same category already available in the market?

Before embarking upon manufacturing of any value added food product, you must get a very clear idea of the market size, the presence of competition and an assessment of the potential demand that you may be facing for the product / Products. Only if you find that a reasonable demand exists for the product, you should begin with the production of your selected value added food products.

Activity 2

Oranges being abundantly available in your area, you get an idea of selecting orange squash and marmalade as possible products for you to produce. You initially want to market the product in the local area and then go for a statewide market. What are the factors you would consider and measures to get an assessment of the market demand for your proposed product line? Using these factors, assess the local as well as the statewide demand for the proposed products.

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Let us familiarize ourselves with the common terms used in product related marketing decisions.

A single product produced by a manufacturer is termed as **product item**. When the manufacturer produces a group of related products, the terms used to describe this related group of products is **product line**. For example, jams, jellies and marmalade would constitute a product line for the value added food products manufacturer. If however, the manufacturer also decides to manufacture fruit based drinks in several different flavours, this would constitute a separate product line for him.

The term **Product mix** is used to refer to the set of all products and items that a particular manufacturer offers for the market. The *width* of the product mix defines the number of product lines offered by a producer, while the *length* of the product mix defines the number of product items offered. The extent to which the various product lines in the product mix are related in terms of production requirements, end usage and use of distribution channels defines the *Consistency* of the product mix.

Small entrepreneurs usually start their business operations with a single product item and then develop a category of related products as a product line. Their growth strategy then may comprise finding new markets for their existing product line or adding new products / lines to their product mix. It is however, important to understand that the product mix should be an optimum one, enabling you to capitalize on your resources and have a balanced growth strategy. Some of the factors as a small entrepreneur, producing value added food products, you must consider while taking your product mix decisions include the following:

1. Capacity utilization of manufacturing facilities and other resources.
2. Utilization of technical know how.
3. Cost efficiencies.
4. Possibility of improving market position through a more complete offer.
5. Profit and sales growth potential.
6. Overcoming seasonality of demand and ensuring stabilization in sales.
7. Expanding customer base and customer satisfaction.

In the context of value added food products, you may need to identify the specific attributes or features that you would like your products to have. These attributes include features like the taste, flavour, colour, their essential nature as completely natural products or products with some chemical preservatives, convenience of handling etc. You must remember that these attributes need to be responsive to the consumer tastes and preferences in the target segments chosen by you.

Activity 3

Study the product mix of a popular manufacturer of value added food products. Identify the different product lines being offered by him. Comment upon the width, length and consistency of the product mix. What in your opinion is the market advantage that he has been able to get from this offer through his product mix?

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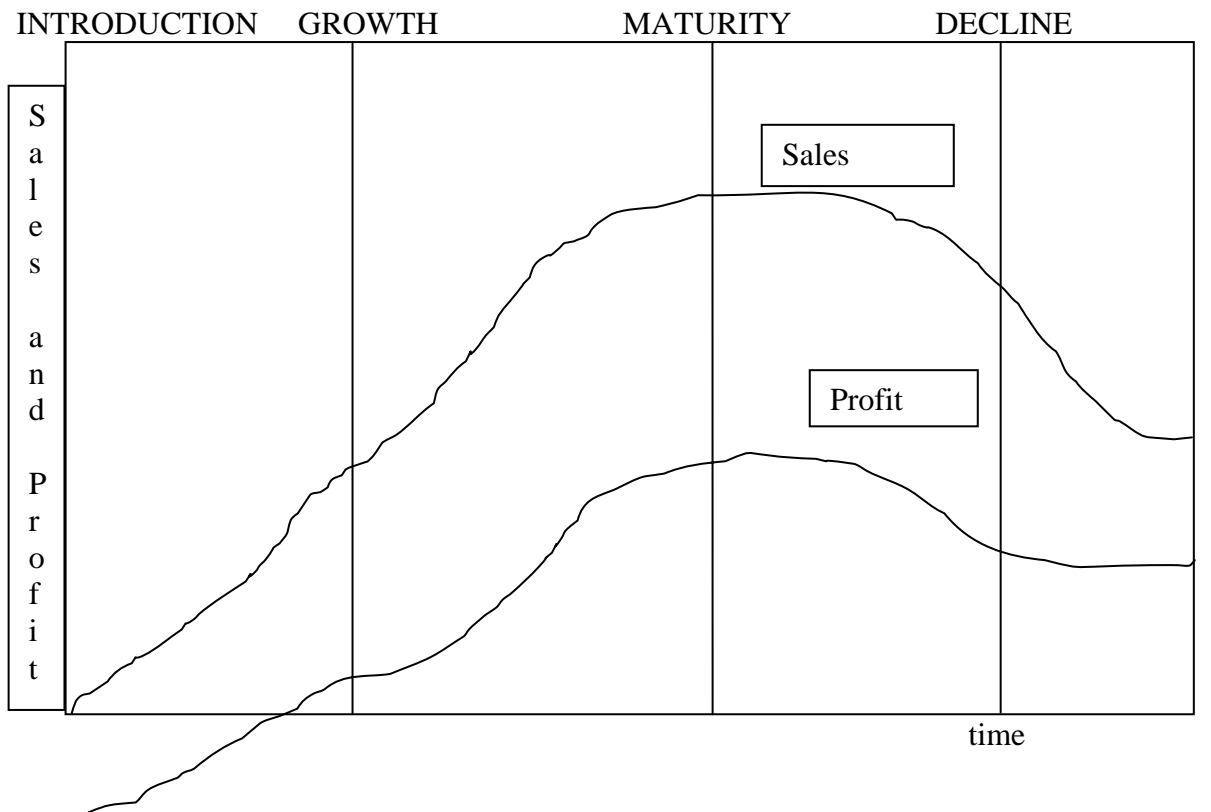
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11.5 THE CONCEPT OF PRODUCT LIFE CYCLE

If you observe the profitable life span of products around you, you would often find interesting variations. While some products continue to have long and profitable market existence, others seem to fade away after some time, some very soon after their introduction in the market place. Like living organisms, products also are seen to pass through a life cycle of birth, growth, maturity and decline. What is, however, different is that marketers can often, by carefully planning their product market strategies influence the duration of the growth and maturity phases and delay the decline. The stages through which a product passes in its development from introduction in the market to decline and possible discontinuance are referred to as the product life cycle. Figure 11.1 shows the various stages in the product life cycle in terms of the possible sales and profit curve. Let us try to understand the different stages and the way products and markets respond to marketing strategies during these stages

- *Introduction stage:* When you have just introduced the product in the market place relatively a few individuals know about the product, a small number of retailers are willing to carry the product and consequently the sales take time to pick up. If you have managed to understand the consumer requirements well, the sales start showing an upward movement though the rate of growth is slow. This is also the stage when on account of your initial start up costs being high, the profits are almost non-existent or very small. You also need to make a fairly substantial outlay on promotion to create awareness about your product offer, which adds to your introductory costs.



- Growth stage:** In case the product launched by you is successful, it is said to enter the growth phase which is characterized by a more rapid growth in sales, on account of growing market acceptance. As fixed costs get spread over a larger number of units, the costs per unit go down and your profit position gradually becomes better. From the view of product strategy, this is an important stage because on one hand, your Consumer Franchise is growing and on the other hand, your competitors are also becoming conscious of your presence. They may like to take steps to defend their market position by reducing their prices, or offering products very similar to yours! You need to be prepared to take on the competition by maintaining product quality, attractive prices and providing the consumer a reason to continue to buy from you, on account of the product attributes. This is also the stage, where you may want to add new product variants to counter competitive overtures, and extend the growth potential of your product line.
- Maturity stage:** As the product becomes more settled in the market, and the competition stabilizes, the sales come to a more stable rate of growth or reach a plateau. The product is in a stage where most of the customers interested in the product have already started using it and the market size is more or less defined, and the demand consists of replacement demand as well as that generated by some new buyers being attracted to the product. Future sales are a function of the population growth and the weaker competitors have exited the market. This is the stage where the entrepreneur prunes his product mix to weed out weaker products and concentrates on the most profitable ones. The maturity stage is usually the longest stage in the product life cycle and is often the most challenging one. You can create opportunities for growth by looking for new markets for your existing products or extend your product line to give a more complete package to your existing customers. Through creative marketing

strategies by either market development or product diversification, or even marketing mix modification you can delay the onset of the decline stage.

- *Decline stage:* Sooner or later most products get replaced by new and better products in the consumer preferences and start facing a sales decline. This may happen on account of changing consumer preferences and tastes, improvement in technology or simply by better substitute coming into the market. As noted above the marketers can prevent the onset of decline stage by innovating and preparing themselves to meet these changing tastes and preferences themselves rather than allowing competitors to come out with improved substitutes.

Once sales start declining, it leads to overcapacity and a general inability to meet costs. Unless you can think of strategies to reverse the decline, it is a good move to cut your losses by getting out of a declining market. Some of the strategies used in the declining market include adding new features to the product to give extra benefits to the consumer, improving the incentives to the distribution channels in order to get better support from them, improving product quality or adjusting the price to make the product more suitable to another market segment.

You must however, always bear in mind that the product lifecycle and the duration of the product in different stages of the life cycle is often a result of the product and market strategies used by the entrepreneur rather than a natural progression that every product must follow.

Activity 4

You have only to think of food products which were once popular and are no longer seen in the market, because consumer preferences related to food have changed so drastically. On the basis of the market survey of your local market, try to identify some examples of value added food products which can be said to be in the various stages of the product life cycle. List these examples

Introduction stage.....

Growth stage.....

Maturity stage.....

Decline stage.....

(Hint: Look for some value added food products which have very recently been introduced in the market, some which have been around for some time and some which are now out of consumers favourite brand set-On the basis of what you have studied in this section, try to classify the products in the above stages).

11.6 BRANDING AND PACKAGING DECISIONS

Branding

In order to enable consumers to identify and distinguish between different product offerings, most consumer and industrial products need to have a

distinctive name and an identifiable packaging that make them stand apart from other products. An important decision in your product strategy is to have a brand name for your products which is easy to remember and recall when the consumer is planning to buy the products. Let us try to understand the different terms that are used in the context of branding

A **brand** is a word, mark, symbol, or a combination of these used to identify goods or services

A **brand name** is the part of the brand consisting of a word, letter, a group of words or letters comprising a distinctive name which is intended to identify the goods or services of a seller or a group of sellers and to differentiate them from those of competitors. The brand name can be vocalized and therefore, can be used to communicate.

A **brand mark** is that part of the brand which can be recognized but not vocalized.

But **trade mark**, on the other hand, is the part of the brand which enjoys legal protection.

Entrepreneurs prefer to brand their products as branding provides several advantages in marketing. Some of these are

- A well chosen brand name helps invoke some of the desirable features of the product, for example Tang, Dairy Milk, Sunfeast, Shaktibhog etc.
- A brand helps in providing a distinctive image to the product and aids in distinguishing it from competitor's offerings.
- On account of easy identification, the brand helps the middlemen i.e. the wholesalers and the retailers in order booking, inventorying and other distribution functions.
- On account of association of favourable experiences with the brand name, branding makes it easier for consumers to develop brand preferences and ultimately brand loyalty.
- Over a period of time, goodwill of a brand becomes a valuable asset for a producer and is referred to as brand equity
- Brand equity, gives the organization a distinct advantage in future product introductions and market development.

You must therefore, think of a suitable brand name for your value added food products before introducing them in the market place. There are certain costs associated with branding in the sense that you would need to promote the brand name and establish an identity for the product by advertising and creating brand awareness. In view of the advantages already mentioned however, a brand becomes an important tool in the strategy for successful marketing by entrepreneurs.

Selecting a brand name: As the essential function of branding is to help product identification, recognition and recall. There are certain considerations which you must keep in mind when selecting a brand name.

- *Suggestive:* A brand name should suggest something positive about a given attribute of the brand for example the above brand names like Tang and Shaktibhog provide a hint about the product attributes of the drink concentrate being tangy in taste or the flour being an energy providing food.
- *Convenient and memorable:* It should be easy to spell, pronounce and remember (Kissan, Amul).
- *Distinctive:* It should be distinctive enough for people to clearly associate themselves with a given product and should not too closely resemble another brand especially in the same product category.
- *Association value:* The brand name partly on account of its memorability and partly on the basis of its relationship with product attributes, should be able to build up a strong association between the company offerings and the brand. This often happens because while promoting the brand, manufacturers repeatedly use some tag line to focus on the key benefit of the brand; For example the Maggie Brand uses the tag line “Easy to cook, good to eat”. Over a period of time, consumers come to associate the value of a time-saving, tasty food product with the brand name Maggie.

Packaging Decisions

Packaging has often been defined as the art, science and technology of producing a container for the product and making it suitable for transportation and sale. A well designed package is an important tool for marketing communication, product differentiation and enhancing the value perception of the product. You have only to look around yourself, to specially in the context of value added food products to appreciate the revolution that has taken place in the area of packaging. The amazing variety of packaging options available today makes it possible for the marketer to use packaging as a strategic advantage in marketing. The choices for value added to products range from the traditional plastic and glass bottles to food grade pet containers, sachets, Tetra packs, aerosol cans and dispensers. The choice available both in terms of material and design is tremendous and it is up to the entrepreneur to select the best possible alternative for gaining the best competitive advantage. While taking packaging decision you must however be conscious of the functions that packaging must perform in order to add value to the product and justify the cost of packaging. The functions that packaging should perform include the following:

1. *Protection:* The most basic function of packaging is protection of the food products from environmental and physical damage to which the product maybe exposed to during transportation, storage and movement from the point of production to the point of consumption and disposal. The various hazards that the product may face during the above stages may include damage due to rough handling, extreme climatic conditions leading to spoilage, contamination, absorption of moisture, loss of fluid and pilferage because of unsafe packing. Your selection of the packaging material and

packaging design must ensure the protection of your product against all these hazards. The cost of packaging must be seriously considered against the cost of possible damage and spoilage during transit and before usage of the product.

2. *Enhancing product appeal:* In the case of food products packaging is being imaginatively used to enhance product appeal. You must understand that in the case of retail situations, the package acts as the silent sales person for the product especially in the self service situations. The package therefore, must *attract attention*, give a *clear idea* of the product; it must *inspire confidence* by looking *clean, hygienic and sturdy*; must be *convenient to handle*, and *to carry and store*

3. *Enabling sales promotion:* Packaging plays an important note in implementing sales promotion schemes as the package can be adapted to give additional benefits to the consumer in several ways For example, Money off package, Premium package, Extra volume for the same price, Benefits given to the consumer for the return of package in the event of a repurchase.

4. *Providing information:* Through labelling, packaging performs the important function of conveying information to the consumer about the product ingredients, prices, shelf life, instructions for use and any special caution that needs to be applied in respect of the product on its storage and usage. In the case of food products, if such information provision is also a legal requirement.

5. *Performance features:* In order to enhance the value for the customer, packages today are also equipped with functional features so that their usage value in the eyes of the consumer goes up. You would have seen ketchup packaged in plastic bottles with dispenser caps, or pickles in spill proof jars or plastic packs with zip lock systems. You may think of innovative ways of adding utility features to your product packaging like creating an aerosol package for salad dressing or a sprinkler cap for masala mixes to provide ease of usage of the product to the consumer. Creative packaging with additional features like these, sometimes results in brand purchase and ultimately brand preference.

Activity 5

A. Try to recall five most popular brand names of value added food products across different product categories. How well these brand names rate on the five qualities of a good brand name suggested above.

Brand 1 (name).....

Brand 2 (name).....

Brand 3 (name).....

Brand 4 (name).....

B. Identify the various functions that packages of value added food products fulfil besides the protection function, by surveying the packages of the value added food products in your local market.

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(Hint A: You have just seen the criteria which define a good brand name. In respect of the brands selected by you, evaluate to what extent these qualities are displayed by the brand names.

B: Protection is the most basic function performed by packaging, on the basis of what you have studied in the section above, comment on additional functions that product packaging is seen to perform in the products chosen by you).

11.7 DIFFERENTIATING AND POSITIONING PRODUCTS

As a manufacturer of value added food products, it would be easier for you to decide on the various alternatives of your marketing strategy if from the very beginning you had a clear idea as to how you want your products to be perceived by the target consumers of your products. According to Philip Kotler, the designing of your offering and image to occupy a distinctive place in the minds of your consumers is called **positioning**. In the context of the product category offered by you in the market, you can take conscious, planned action to assign a specific image and meaning to your products for your target market. For example, for your value added food products, you can select a position of completely natural food products with no artificial additives or preservatives, or that of a value for money product, offering good nutritive value at economical rates or one that offers a complete range of possible flavours, or one that comes out with new, exciting and innovative taste combinations. Once you decide on a particular positioning to take, your marketing decisions like product attributes to focus on, packaging, promotion, distribution will need to be taken in consonance with the desired position so as to reinforce the desired image in all aspects of marketing activities.

Positioning is based on how you want to differentiate your product offer from your competitors' products. Product differentiation can be created on several bases some of which, relevant to value added products are discussed below:

Product attributes: As mentioned earlier, you can identify product attributes which you would like to focus upon, through which you are offering a distinctive value to the customer. This could be in the form of a particular taste (Maggie Hot and sweet tomato Ketchup) or the most complete range of

flavours being offered in fruit juices or jams, or a low calorie variant on account of non-addition of sugar in your range of fruit juices and preserves. When trying to identify the attributes of which you want differentiate your products, you must consult your potential customers to have an idea of the attributes that are important to them.

Product form: Products can be differentiated on the basis of the form in which they are offered. For example, Masala mixes can be offered as a dry powder or a paste, provided this differentiated form offers a distinct advantage to the consumer in terms of usage or storing convenience.

Product packaging: As noted earlier in the section 11.6 on Packaging, we had discussed how packaging can be used to give a differential advantage to the customer. Reusable packages impart a distinctive value to the consumer, as do other convenience factors like dispenser caps, easy to handle bottles, sachet packs etc.

Product quality: You can consciously take the decision to offer a certain level of product quality and use this basis of differentiation to justify your prices. A quality differentiation must be consistently supported by product performance, otherwise it may prove to be counterproductive.

Pricing differentiation: You can differentiate your product on the basis of most economical prices or on a value for money basis. Alternatively, to convey a high quality image, entrepreneurs sometimes follow a high price strategy (e.g. Mothers recipe strawberry preserve) and aim at the high profile of the market.

Product delivery: It is also possible for small entrepreneurs to get an advantage in the market by offering service advantages like free home delivery especially for large buyers. This may specially work for you if you offer a complete range of value added food products rather than just one or two items.

Activity 6

Survey the market around you and study the leading brands of value added food products. Study their marketing communication as well as packaging. What, according to you are the ways in which these brands have been differentiated from their competitors? Try to identify the basis in each case and justify your answer:

- Brand 1.....
- Brand 2.....
- Brand 3.....
- Brand 4.....
- Brand 5.....

(Hint: You must study the advertisements of all the five brands selected by you and the information provided on their packages. Study the main focus in each advertisement to understand the basis of differentiation being pursued by each brand).

Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. What do you understand by the terms product, product mix and product line? Explain by giving suitable examples of value added food products.

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2. What are the ways in which products can be classified? How would you classify the following value added food products?

- a) Jams, jellies and marmalade.
- b) Premium fruit juice.
- c) Fruit pulp to be used for manufacture of fruit based confectionery.

Justify your answer by giving reasons for your classification.

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3. How is the concept of Product life cycle used by entrepreneurs to plan their marketing activities? What are the steps that can be taken to delay the decline stage, in the case of value added food products?

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4. What is the advantage of branding of food products by a small entrepreneur? What are the characteristics of a good brand name? How would you advise an entrepreneur planning to introduce a line of natural fruit juices and seeking the suitable brand name for his products?

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5. What are the key functions that packaging can perform? Explain with the help of suitable examples.

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6. Assume that you are an entrepreneur producing a range of pickles, chutneys and other preserves. On the basis of inputs studied in the Unit, what are the ways in which you can differentiate your products?

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11.8 LET US SUM UP



A product represents the offer that an entrepreneur makes to the market in order to satisfy an existing consumer need and earn a suitable return on his investment. In the context of value added food products, this unit tried to define the concept of a product, the product mix and the related terms. The unit also explained the way products can be classified and the criteria that should be

applied, while making the selection of a suitable product to manufacture. The concept of product life cycle was covered to enable you to understand the different stages in the market development of a possible value added food product and therefore equip you to identify suitable strategies for various stages in the Product Life Cycle (PLC).

Branding and packaging are important decisions for an entrepreneur as these would enable him to carve out a distinct identity for his products. Advantages of branding and packaging, as well as key considerations that you should bear in mind, while taking these decisions, have been explained.

In the highly competitive market faced by value added food products, product differentiation plays an important role in helping consumers to understand the different values that are being offered by competitive products. The unit also explains the concept of brand positioning and product differentiation to help you apply these important concepts in the successful marketing of your value added food products.



11.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

1. Refer to section 11.2 Product: Meaning and significance and observe the market for suitable examples.
2. Refer to section 11.2 Product: Meaning and significance.
3. Refer to section 11.5 on product life cycle and specially to the decline stage under the PLC.
4. Refer to section 11.6 and look for the inputs given under the heading of branding and brand name selection.
5. Refer to section 11.6 and look for the inputs provided under the heading of packaging.
6. Refer to section 11.7 and look for inputs provided under the heading of product differentiation.

11.10 SOME USEFUL BOOKS

1. “Entrepreneurship Development for Women” a Manual for Trainers, ILO-Sida If publication, December 1996A.
2. “Principles of Marketing”, Philip Kotler and Gary Armstrong, Prentice hall of India, Seventh edition 2005.
3. MS-93 “Management of New and Small Enterprises”, Block 4 – Operating the Small Enterprise. SOMS, IGNOU Publication, 2004.

UNIT 12 SETTING THE PRICE

Structure

- 12.0 Objectives
- 12.1 Introduction
- 12.2 Importance of the Pricing Decision
- 12.3 Understanding the Basic Elements of Pricing
- 12.4 What should you know about Costs?
- 12.5 What should you know about your Customers?
- 12.6 What should you know about your Competitors and Trade Practices?
- 12.7 Understanding Pricing Objectives
- 12.8 Alternative Pricing Policies that Entrepreneurs follow – Relationship between Price and Quality
- 12.9 Putting Pricing in Practice – What should you know before Implementing the Pricing Decision
- 12.10 Let Us Sum Up
- 12.11 Self Assessment Questions
- 12.12 Some Useful Books

12.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the various types of costs in an enterprise;
- describe the relationship between cost and price;
- apply the understanding of cost behaviour to price setting;
- define the objective you want to achieve through pricing;
- explain the various methods used by small enterprises for pricing;
- get an understanding of consumers realization to pricing decision; and
- set prices appropriate for your product and market situation.

12.1 INTRODUCTION

As an entrepreneur, pricing is one of the most important decisions you will have to take in respect of your products. You will find that a lot of your decisions become dependent upon the price that you are able to fetch from the market for your value added products. Not only the price set by you should cover your costs, it should also provide you with a reasonable margin as your earning. However, the consumer that you are planning to focus on for your products, must be able and willing to pay the prices that you are planning to set, otherwise the product will not be able to generate the demand that you wish to generate. As you are not the only one offering these products, you will also need to take into consideration what the direct and indirect competitors are charging for similar products. In this unit we will look at the factors that influence the pricing decision, the various cost that you must know, and the possible reactions of consumers to different pricing levels. We would also go through the steps in the price setting process, the various pricing objectives and the inputs you need to have before implementing your pricing decision. These inputs would enable you to take appropriate and ultimately, profitable pricing decisions for your products.

12.2 IMPORTANCE OF THE PRICING DECISION

Pricing is one of the key components of the marketing mix. In order to appreciate the importance of this variable put yourself in the place of a consumer. When you want to buy something, one of the first things you ask for is the price of the product. It often becomes the reason of your deciding to buy or not to buy. Ask yourself the question- why do you decide not to buy if the price does not seem appropriate? The answer is that you do not buy if you think the product in question is not worth the money that is being asked for. The exchange between the buyer and the seller is directly dependent upon the valuation the buyer puts on the product. If his valuation, i.e. his own perception of what the product should be worth, does not match the price that the seller has put on the product, and the exchange will not take place. Pricing as a decision is therefore important because

- It allows the consumer to assess the monetary value that he would need to pay to acquire the product.
- Prices strongly affect the consumer's valuation of the quality of products.
- It is the only source of revenue you would be earning. Your price level becomes the determinant of what revenue will you be able to generate, provided there is demand for your product.
- Pricing decision infringes upon your other decisions in the marketing mix. The price level contemplated by you defines the margin you will be able to make over your costs. Thus margin determines what are the kind of distribution costs you will be able to pay to your distributors and the type of resources you will be able to employ for your product promotion.
- Conversely, you will find that price is also a strong determinant of demand levels. The basic law of demand tells us that the quantity purchased of a given product increases if the price of the same is lowered and vice versa. While it is not true of necessity goods, prices do affect the number of people who will be able to afford the product and therefore is a factor in defining what is the size of the market at a given level of price.
- Your prices also strongly affect the positioning you aim at in the market. The price points enable the comparison of the value offered by you with the value offered by your direct and indirect competitors and allow the consumer to assign a positioning to your product vis-à-vis your competition.

A small entrepreneur is therefore very conscious of the extreme care that he would need to exercise to be able to set the right price for his product, in this case the value added food product that he has chosen for himself. Let us now try to understand the basic foundations of the pricing decision.

12.3 UNDERSTANDING THE BASIC ELEMENTS OF PRICING

At the basic level, you must clearly understand that price determination depends on three fundamentals. These are consumer value, costs and

competition. Let us discuss each fundamental element in brief and understand their interplay in the pricing decision.

Costs represent the money value of everything that you will have to spend or utilize in order to create and offer your product for market. You need to be sure, in the short run as well as in the long run that your cost would need to be covered for you to survive in the market. You therefore, cannot afford to price your product below the cost at which you have produced it because you will be incurring losses instead of earning profits. For example, if it costs you Rs. 20,000 to produce 1000 bottles of fruit jam, another Rs. 2000 to package them and Rs. 500 to transport them to the nearby markets, you cannot afford to price one bottle below Rs. 22.50 because then each bottle sold would result in losses. Costs thus represent the floor below which you should not go in taking your pricing decision.

The consumers capacity and willingness to pay a given price is another variable that you will have to consider. In a given market, what is the value that consumers assign to a product like a bottle of fruit jam? How many of them, are willing to buy a bottle of jam, without the guarantee of a known brand name, at a price of, let us say Rs. 35 per bottle ? You will have to make this assessment, because in a given market the number of people, who are able and willing to buy at the price being thought of by you, will determine the demand that exists at that price level. You would need to assess what is the level of price at which the consumers in your chosen market segment are willing to buy your product, simply because above that level you will not be able to find any takers for your bottle of jam. The consumers ability to pay for a product in a given market thus defines the ceiling above which you cannot afford to charge, because a very limited market would result at that level.

It must now be clear to you that there are two limits, lower limit and upper limit that you must consider in your pricing decision, Costs on the one side form the lower limit and the customers ability to pay on the other side, constitutes the upper limit beyond which you should not go while taking the pricing decision. You may have the freedom of charging what you want between these two levels, if you are the only one in that market producing fruit jam. Unfortunately, this is seldom the case because all kinds of value added products like jams, jellies, fruit juices and pickles and the other range of such products, are there always produced by other producers who are your competitors. All the producers who are in the market offering the same product that you are producing or are planning to produce are your competitors. As their prices are also commonly known to your prospective customers, you do not have the freedom of charging prices that are too different from those being charged by your competitors. The third dimension that you would have to study before you set your prices is the dimension of your competitors. To summarise the three basic elements you would need to define the following:

- Who are my customers and what is the value they put on a product like mine? In other words, what is the price at which they will be willing to buy?
- What are my total costs in producing, distributing and promoting my product?
- How do my competitors price the same or similar products?

Activity 1

Talk to about 5 people who are the likely consumers of the value added products and ascertain the possible prices they may like to pay for the following:

- A. A bottle of mixed pickle 9250 gms)
- B. Tomato (200 gms)
- C. Fruit squash (500 ml)

How do these prices compare with the market prices of these products? Comment upon the gap if any.

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12.4 WHAT SHOULD YOU KNOW ABOUT COSTS?

There is a common and widespread belief that costs determine prices. This is on account of the fact that costs are one of the important elements of the pricing decision as you saw in the previous section. You also saw that factors like demand and competition are the other two important factors that help you in finalizing your price. So, while costs continue to be important, their importance cannot be exaggerated you must clearly understand that if your costs are working out to be of a certain level, and covering them results in a price at which there is little or no demand, then you will have to seriously reason out costing and find out ways of minimizing costs in order to survive in the market. In order to clearly understand your costs, let us try to find out the various types of costs and see how they can be combined to give the total cost.

Costing is the way you calculate how much each individual product produced by you will cost you to produce and deliver. In order to realistically price your product, you need to cost the product first because then you will be able to

1. know what is it that you must recover and assess what margin you need to set to earn a reasonable profit;
2. set prices for each product; and
3. match your product offer with the expectation of your chosen set of target customers.

You will find that there are major differences in costs between one producer and another. They may be due to the way they source their raw materials, or utilise their resources or the way they use manpower and utilities like electricity and water. They will also have different cost structures if they have different skill levels and use different grades of raw materials, or different types of packaging. Let us list out the types of costs that may be incurred in the production of value added products.

1. **Direct Costs:** These costs are directly related to the manufacturing activity of the product under consideration and include :
 - a) *Direct material cost* - Actual costs of raw materials that go into the finished product.
 - b) *Direct labour costs* - Cost of the labour or manpower that is used to produce the product. Even if you are using the members of your own family, you must assign labour costs. These would be equal to what they would have earned as workers elsewhere if they had not been engaged in the home production activity.
 - c) *Other direct costs* – Costs of the facilities like fuel, and rent of machines if any, packaging material, transport, storage expenses or tools and equipment etc.

2. **Indirect Costs:** These are the costs that cannot be directly linked to the manufacturing of the product but are required to make production possible. You must also remember that these costs will continue to be incurred whether the production of your value added products is going on or not. These costs include:
 - The rent of the building, maintenance of the building, equipment machines etc.
 - Power and electricity, water, and other municipal costs like taxes.
 - Costs of interest on loans that you may have taken.
 - Salaries of people engaged by you who are not directly involved in the production e.g. helper, delivery boy or some consultation fees that you may have paid for general administration or production/marketing of your value added products.
 - Stationery postage and telephone if any.
 - Costs incurred in providing your product.

You may also look at costs in another way to identify them as fixed and variable costs. All costs that you incur can be classified either as fixed or as variable costs.

Fixed Costs: Costs are those that do not change with the quantity of products produced, i.e. these are costs that cannot be avoided even if no production is being undertaken on a particular day or in a given period. These costs include rent of the building, salaries given to people involved in the production activity, interest on loans, monthly charges of electricity power and water etc.

Variable Costs: on the other hand variable costs are those that vary with the level of output. They directly depend upon the quantity of products being produced. They include the raw material costs, machine operating costs, direct labour costs, packaging, transportation of finished goods etc. You would appreciate that variable costs would arise only when production is going on. On a given day when there is no production activity, the variable costs would be zero.

In order to be able to calculate the total cost per unit of your product, for which the pricing decision is to be taken, you should know the following:

1. Total fixed costs of your organisation
2. Total variable costs for the manufacturing of that product
3. Period over which the fixed costs are being incurred

❖ $\text{Cost for each product} = \text{Total fixed costs} + \text{Variable costs of the product}$

The factors which cause your total costs to rise and make you uncompetitive include the following:

- Your lack of knowledge or uncertainty about the needs of your customers regarding the value added products.
- Inadequate knowledge about the sources of raw materials and availability of others resources.
- Your inability to purchase raw materials in large quantities.
- Uncertainty about the quantity to be produced each day or per period.
- Lack of basic skills relating to introduction or selling of value added products
- Inadequate knowledge about the low cost alternatives for raw materials/equipments/workers.
- Lack of appropriate standardisation in the production processes, packaging and distribution.
- Inadequate training of labour and other production related staff.

Activity 2: Working out the total cost of the product

Take the following table as an illustration of the various costs associated with the product of a given value added product like jam or fruit preserve. Using the information given above, work out the total cost of the product.

| Item/material required | Quantity | Cost/rate per unit | Quantity required per unit | Cost/unit |
|------------------------|----------|--------------------|----------------------------|-----------|
| Unit | 30 kg | Rs. 25 per kg | 2 kg | Rs. 50 |
| Additive | | | | Rs. 5 |
| Sugar | 15 kg | Rs. 8 kg | 500 gms | Rs. 4 |
| Packaging | | Rs. 2/bottle | | Rs. 2 |
| | | | | Rs. 61 |

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In addition there are 2 workers involved per day who produce 300 kg of preserve per month. Their salaries are Rs. 1500/month each. Cost of labour per unit i.e. per kg production is Rs.10.

The direct cost of production = Rs. 71 (=Rs. 61 + Rs. 10 = Rs. 71)

What is the price that you would like to set?

Hint: To the above you will be required to add all the indirect costs divided by the total number of units produced per month, to get the indirect cost per unit. Suppose these costs are Rs. 5/-.

Your total cost of production so therefore = Rs. 71 + Rs. 5 = Rs. 76.

$$\therefore \text{Total direct cost per unit} + \text{Total indirect cost/unit} = \text{Rs. 76.}$$

Once the goods are produced, you have to incur distribution costs to let the goods reach the hands of the consumer. If you want to sell through dealers i.e. wholesalers and retailers, you will have to incur the cost called distribution margin. If you want to sell directly, you still have to incur delivery costs but these will be in the form of transportation, warehousing and keeping the inventory of the finished goods. Assume, for the sake of simplicity that these selling costs are equal to Rs. 4/ unit. Your total cost of the product is therefore Rs. 80 (Rs. 76 + Rs. 4) = (Cost of production) + (Cost of delivery).

In order to determine your price, you will have to decide the margin you would like to charge to get a reasonable profit margin. The total price per unit, to be charged is given by the simple formula

$$\text{Price} = \text{Total cost/Unit} + \text{Markup margin per product}$$

Suppose you decide to earn a 15% margin on your total cost. This works out to Rs. 12. The final price that you would need to charge would be equal to Rs. 92 per kg. In case you want to sell in 500 gm bottles, the price should be around Rs. 46.

Activity 3

Based on your information of the market price of raw materials and an assessment of labour costs involved, try to work out the possible margins being charged by 2 branded value added products of your choice.

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We have in the above example used the direct cost, indirect cost classification to work out the total cost and estimate the final price.

You may also use the classification of fixed and variable costs for the same exercise for calculating the total cost.

In order to work out the total cost, you would need the following information.

1. Fixed cost of the Production Unit
 - a) Cost of total machines & equipment
 - b) Cost of rental of the building
 - c) Cost of furniture and fixtures
 - d) Cost of installation transport etc.

2. Monthly payments of the unit
 - a) Payment of electricity/water/telephone
 - b) Salaries of the workers if any
 - c) Salary of self
 - d) Office costs if any
 - e) Cost of production

3. Variable cost of raw materials and labour used.

Using the above information, work out the total cost/unit of any value added product of your choice.

12.5 WHAT SHOULD YOU KNOW ABOUT YOUR CUSTOMERS?

The basic objective of the pricing decision is to set it at a level where exchanges will take place i.e. the price at which a large number of consumers will be willing to buy.

You must also appreciate that in a country like ours, your potential consumers can also be your competitors in the sense that they can produce most of the value added products you intend to offer, by themselves. While evaluating pricing options, you must keep in mind that if the prices are too high, consumers may simply not consider the products worth the money.

From the point of view of the consumer, prices become barriers to purchase in both circumstances, when they are too low or too high. Above a particular price, the product is perceived as being too expensive and below a particular price, it is perceived as being of too low a quality to be considered desirable. Looking at the consumer group you wish to cater to, you must get an appropriate idea of these two limits. These limits constitute the range above which or below which you should not set your price. It is a good idea to get an assessment of the prices that consumer will be willing to pay for your type of value added product through discussion with consumers or a survey of the prevailing market prices for similar products,

Another assessment that you would need is the price elasticity of demand. This price elasticity of demand is a measure of what is the responsiveness of consumer to small changes in price. Is the product of that type where the price

consciousness of the consumer is very high and any small change in price by other producers, will shift the demand in favour of the competing product? You can protect your product from direct price competition by differentiating it on the basis of quality, freshness, taste, flavour, low sugar content or any other value that you may choose to include. To summarise, the different factors that you would need to know about your consumers include:

- What are the prices that your consumers are willing to pay for your product?
- What is the approximate demand that is likely to result at different price points?
- How sensitive are consumers to changes in prices for your type of product?
- What are the factors other than price, that consumers assign value to when they select value added production?

Activity 4

For a product like pickles, find out from different sections of your prospective consumers the prices they are willing to pay for a 500 gm bottle of good quality pickle. Based on the assessment of costs as in activity 1, what type of margins will these prices enable you to get ?

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12.6 WHAT SHOULD YOU KNOW ABOUT YOUR COMPETITORS AND TRADE PRACTICES?

At any given point of time, wherever you contemplate putting a value added product on offer, you must be aware that there are several competitive products already on the market. People who fulfil the same need of consumers, that you are trying to fulfil through your product, are your competitors. As noted in the earlier section, value added products represent a category where the consumer himself may also be a competitor.

While pricing your product, you need to be aware of the prices that your competitors are charging. A casual survey of the retail market would give you a clear idea of the final price that the existing consumers are paying for your competitors' product. In order to give them a reason to buy, you need to either price the product a little below that of the competitor while keeping similar levels of quality, or include some other value in the product for which the consumers are willing to switch their brands at the same price or even slightly higher prices. You must clearly understand that the competitors' prices create what is called a reference point for the consumers against which they assess all new offers. You, therefore, cannot afford to have prices that are radically different or unsupported by a reasonable value proposition.

In the next unit, you will study in detail about the distribution practices that emerge to bridge the gap between points of production and points of consumption. It is, however, relevant here for you to understand that distribution costs also have to be absorbed in the final price of the product. When you develop value added products, in order to take them to the point where consumers can access them, you will need to use the services of middlemen like wholesalers and retailers. These distribution agencies operate on the bases of margins that they earn on the products they help to sell. In common parlance, the terms on which you share the distribution of your products to the markets selected are known as terms of trade. These include the quantum of margins (in terms of percentage) payable to the distributors, the types of services performed in return, the type of warehousing and promotional support provided and the terms of payment i.e. cash or credit, terms of credit etc.

As distributors are independent businessmen in their own right and provide the essential services of creating access for the customers to your products, for a new manufacturer there is seldom any choice but to follow and abide by the existing terms of trade. You should, while taking the pricing decision, be aware of what are the costs generated by the different types of channels of distribution you can select. These costs will also become a factor in the total costs that would need to be recovered through your pricing decision.

12.7 UNDERSTANDING PRICING OBJECTIVES

For your enterprises, you may have several objectives at a given point of time. Your pricing goals would reflect what you want to achieve as an entrepreneur. For example, a new entrepreneur in a highly competitive environment has the primary objective of survival and therefore, his pricing objectives would reflect the need to be able to merely survive in the market place for the time being. The various pricing objectives that entrepreneurs seek include:

- Survival
- Maximising current profit
- Maximising market share
- Market entry objectives
- Product quality leadership

Survival as an objective is followed if the enterprise is faced with more capacity than the demand, intense competition and changing preferences of the buyers. The prices are set at a level which will enable the entrepreneur to stay in the market as long as possible. The entrepreneur, in such conditions fixes the price at a level which covers his variable and fixed cost and he tries to stay in business. This is a very short term objective and soon the entrepreneur will have to decide how to add value to his offer or be prepared to exist in the market.

Another short term objective that many small entrepreneurs follow is that of maximising current profits. When you understand that there are different demand levels that will result at different prices, and you are interested in whatever maximum you can get from the market, you would select a price level that produces, for a given demand level, the highest current profit for

you. You must however, know that under this objective the entrepreneur may be ignoring the long term objectives of his organisation.

Some entrepreneurs, specially those who have attained a certain size of business are interested in increasing their share of the market because they believe that a larger customer base will allow them to cut their costs and in the long run allow them to have higher profit. Their pricing objective is to maximise market share, and they will select the lowest possible price, if the market is price sensitive. You are all familiar with the example of Nirma washing powder. Indian consumers of detergent are very price sensitive. At the time when established detergents like surf and sunlight were being sold for Rs. 30-35 per kg. Nirma was introduced at a price of Rs. 6 per kg. It continued with similar price levels for quite some time because the objective was to take a large share of the market.

This strategy is also termed as particular pricing because this enables you to penetrate the market, in a competitive but price sensitive situation sometimes, where the entrepreneur is able to create a unique or an innovative product which is new to the market and therefore has a great novelty value, he is in a position to charge extra for the novelty value of the product. The pricing objective that is selected in such circumstances is called market skimming. The product is initially priced very high, so that the customers with higher paying capabilities and with current desire for the product will be attached and will give initial high profits to the entrepreneur. As the novelty wears off and the product gets more well established, the prices are reduced to a level where the larger population can afford to pay. The sales margin will go down but the higher volume will still allow the entrepreneur to make profits.

Sometimes, entrepreneurs may wish to present their products as the highest quality products and charge high prices. In this case, he is conscious that his prices limit the total size of his market, but pursues that objective in the hope that his product quality leadership will be established and in the long run it will be able to create a reputation for high quality.

As an entrepreneur, you need to select an appropriate pricing objective based on what are the overall business objectives you are seeking at a given point of time.

Activity 5

From among the above pricing objectives, what are the objectives you would like to select for yourself?

- a) At the introduction stage
- b) At the business growth stage

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12.8 ALTERNATIVE PRICING POLICIES THAT ENTREPRENEURS FOLLOW – RELATIONSHIP BETWEEN PRICE AND QUALITY

Variable Price Policy

Under this policy, different price are charged for different customers depending on the situation prevailing in the market. Some situations under which variable price policy is adopted are:

1. Difference in the size of the customers (e.g. bulk customers may be offered lower price);
2. Difference in the anticipated business from different customers;
3. Difference in the bargaining power of the customers;
4. Difference in the demand and supply position at various locations;
5. Difference in the customers' ability to pay; and
6. Ignorance of the customers.

Some entrepreneurs adopt variable price policy in their effort to maximise profits. They determine the minimum price to be charged by the total cost of the product, and the maximum price by the customers' ability to pay. Bargaining is usually resorted to in finalizing a deal. As such, this policy may be detrimental to the long-term interest of a firm.

Base Price and Discounts Policy

Under this policy, a base price or least price is used and varying price discounts are offered to different categories of customers. Under the variable price policy, the price is charged according to the particular situation. However, under the base price and discounts policy, discounts are offered uniformly to all customers and each one of them can avail these on satisfying the stipulated conditions. Discounts are of several kinds: **Trade discount** is given to a trader to cover his costs and provide him with a margin as incentive to deal in the product. **Quantity discount** is offered to bulk purchasers because of their value to the seller. **Cash discount** is given to the customer making cash down or immediate payment. **Seasonal discount** is given to boost the sale of a product during slack season. Electric fans, woollen garments, and cooler pumps are typical examples where seasonal discounts are offered.

Market Rate Policy

Prevailing market rate, many times is the basis on which an entrepreneur determines the price of his product. If the nature of the product is such that it is largely indistinguishable from those of the competitors, or if it is found that all manufacturers are charging more or less the same price for their products, the market rate policy of pricing is usually adopted. In case the entrepreneur finds that the prevailing market rate is not economical for him, he has to lower down his costs somehow rather than increasing the price unilaterally. This method is commonly used in the case of unbranded products like oils and chemicals, and services like courier, tailoring and car or scooter servicing. One advantage of

this policy, especially for new small enterprises, is that they get some immunity from the vagaries of price wars.

Market Skimming Pricing Policy

Under market skimming pricing strategy, a very high price is charged in the beginning with the objective of recovering the investment in a short period. High price is usually supported by heavy product promotion. This strategy is seldom possible except when the product is an innovative one and is expected to command good reception from the customers. One cannot continue with such a strategy for a long period of time as high price acts as an incentive to the competitors to enter the field. The price is permitted to fall as the competition sets in.

Market Penetration Pricing Policy

Market penetration pricing strategy calls for a very low initial price in order to penetrate into the market. The strategy puts emphasis on creating a mass market for the product at low margins. This strategy can be adopted when the demand is expected to be price elastic, i.e. customers are price sensitive, and when the economies of large scale production are substantial.

12.9 PUTTING PRICING IN PRACTICE – WHAT SHOULD YOU KNOW BEFORE IMPLEMENTING THE PRICING DECISION

When you decide upon a particular price, there are important aspects of buying behaviour that you should be aware of before implementing the price decision.

- For the consumer prices are a quantitative value, while quality, branding and promotion are qualitative and difficult to assess. Your price point becomes a reference point for them to make assessment about the product.
- As said earlier, price must be viewed by your target group as being affordable, in the consumers below it should offer good value for money.
- However, if the price is too low in comparison to similar products, the consumers may tend to think that it is of inferior quality. You must carefully assess, that for food products consumers may not like to compromise on essential quality, so even if you are offering reasonable quality, too low a price may give a low grade quality usage to your product and will turn away consumers who are quality conscious.
- Packaging and labelling add to the cost and therefore, result in higher prices. Some entrepreneurs may try to economise economies on these costs but please remember, inferior packaging may allow you to set lower prices but will also interfere with the quality of the product as and when the product reaches the consumer.

12.10 LET US SUM UP



Pricing constitutes one of the most important decisions of the entrepreneur. It often affects the growth and survival of the enterprise. In this unit, you have

been given inputs on factors which influence the pricing decision, pricing objectives and the importance of costs consumers and competition in the pricing decision.

Entrepreneurs may like to pursue different objectives at a given point of time and consequently follow different pricing policies. The unit discusses different pricing policies that small entrepreneur may implement, in view of their objectives.

The unit also introduces you to possible buyer reactions to price related decisions and may help you in taking the same into action while you set your prices.

12.11 SELF ASSESSMENT QUESTIONS

1. Why are pricing decisions so crucial for the entrepreneur in marketing value added products?
2. What are the different types of costs you will incur while making
 - a) Jams
 - b) Pickles
 - c) Fruit juice concentrate

Explain how their costs will affect your pricing decision.

3. Carry out a survey of the prices of the value added products being considered by you for production. What are the different price ranges that are offered by your competitors?

12.12 SOME USEFUL BOOKS

1. Course Material on MS-93: Management of New and Small Enterprises, SOMS, IGNOU.
2. Satish Taneja and S.L. Gupta, Entrepreneur Development: New Venture Creation, by Galgotia Publishing Company, New Delhi.

UNIT 13 DEVELOPING AND MANAGING DISTRIBUTION

Structure

- 13.0 Objectives
- 13.1 Introduction
- 13.2 Direct or Indirect Distribution
- 13.3 Types of Intermediaries
- 13.4 Implications of Using Intermediaries: Channel Levels
- 13.5 Selecting an Appropriate Channel
- 13.6 Physical Distribution Tasks: Distribution Activities and Logistics
- 13.7 Issues in the Physical Distribution Process
- 13.8 Let Us Sum Up
- 13.9 Key Words
- 13.10 Self Assessment Questions
- 13.11 Some Useful Books

13.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the importance of distribution decisions for the marketing of value added food products;
- identify the various options available for distribution of value added food products;
- make appropriate selection from among the distribution choices available to you;
- evaluate the advantages and disadvantages of selling through retailers and wholesalers;
- assess the margins that you need to pay to your distributors and measure the impact of distribution margins for the pricing of your value added products;
- demonstrate an understanding of the processes involved in the distribution of goods; and
- evaluate the performance of the channel members used by you.

13.1 INTRODUCTION

As a manufacturer of value added food products, you need to make your products available to the customers who can then decide to buy and consume them. In the previous unit, you have gone through the processes through which manufacturers promote their goods and create demand for their products. In order to be able to consume the products, the consumers require the product to be made accessible at places near them. As the consumers of your products are scattered in large geographical areas it may not be possible for them to approach you directly. Similarly, it may be difficult for you to reach the individual consumers on a direct basis. The decisions that you need to take in order to make your products available for consumption to the final customer are referred to as distribution decisions and form the fourth “P” of the marketing mix for products and services. We will explore the various options that you may like to consider in order to make your value added food

products available to the final customers of your products. This unit enables you to identify and select between channel options, evaluate whether direct or indirect distribution is a viable option for you and explore the various tasks that are required to be undertaken to enable the physical transfer of goods from the point of production to the point of consumption.

13.2 DIRECT OR INDIRECT DISTRIBUTION

As a manufacturer of value added food products, you are aware that the conversion of these products into revenue for you would not take place unless customers buy these products and continue to do so. For them to be able to do so, it is important that the Products are made accessible to them at places that are convenient to them. Consumption does not take place unless the goods are available at the right place, at the right time, in the right quantity and at an appropriate price. The term distribution refers to the process of moving the products from the point of production to the point of consumption so that the products become accessible to the people who may like to consume them. When a manufacturer establishes direct linkages with his consumers and sells directly to them without using any intermediaries, this option is called direct distribution. This option is usually possible when the customers are few in number and an individual customer is large enough to give you sufficient sales volume, as in the case of organizational customers. As a producer of value added food products, for example, if you are able to secure large orders from restaurants, canteens or hotels; you can easily supply the products directly to these customers as this will enable you to economize on your distribution margins and establish a direct rapport with your clients. Direct distribution as an option offers several advantages. Direct distribution would involve using your own sales force and arranging the delivery of goods through your own resources. Alternatively, direct selling can also be done by obtaining your orders through direct mail or telephone.

- It allows you to save on distribution margins of commission which are required to be paid to the intermediaries like retailers and wholesalers.
- This saving can be often utilized to offer very competitive prices to your customers; The low selling price can give you a competitive advantage vis-à-vis your competitors
- Your direct contact with your important clients can enable you to customize your value added food products in accordance with the needs, tastes and requirements of the customers.
- You can have a greater control on the final price and the terms of sale offered to your customers.

There are, however, certain disadvantages of using direct distribution. Your initial investment in creating facilities for storage, warehousing, transportation and handling of material becomes substantial. When you use direct distribution as an option your working capital requirements on account of salaries to the sales force as well as delivery related expenditures are higher. The geographical area that you can cover on your own is often limited and therefore, your market becomes limited to local markets or a few large organizational customers. In such cases, your dependence on a single or over a few organizations is so high that discontinuance of orders from any one of them could seriously affect the profitability of the business.

On the other hand, if your customers are individual household consumers, the economics of direct distribution does not work out. Individual consumers may be scattered geographically, and the individual order size per household will be small. In such cases it is difficult, if not impossible for you to reach all your customers on your own. To reach a large number of individual customers, producers use intermediaries like wholesalers and retailers. These intermediaries are independent organizations that enable you to reach your final customers by providing distribution related services to you for an agreed trade margin. When you use intermediaries to reach your final customers, the mode of distribution is called indirect distribution. The advantages of using indirect distribution include the following:

- Low initial investment in distribution facilities.
- Relatively lower working capital requirement in relation to the distribution function.
- Large coverage and access provided to a far larger number of customers.
- Benefits of specialization accruing from the intermediaries.

Your choice of direct vs. indirect distribution is determined by the composition of your customers. As mentioned above, if your customer base is composed of organizational customers direct distribution is a better option. Indirect distribution is a more viable option when your customer base is composed of individual households. These are choices that you need to make at the beginning of setting up of your business and selecting your target customers. You may like to work with a few organizational customers or may like to address the needs of individual households. This decision in turn will determine your choice of direct or indirect distribution.

Activity 1

Make a survey of about ten retail shops in your neighbourhood to collect information on the type of value added food products carried by them. List these products. Try to identify products that do not come from large multinational or national providers. Your list will tell you that quite a few small entrepreneurs today use the indirect channel of distribution for their value added products. Discuss with the retailers to find out the type of retail margins that have been paid for these value added products by the small and medium entrepreneurs.

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13.3 TYPES OF INTERMEDIARIES

The set of organizations, outside your own firm, selected by you to enable your final customers to access your products is known as channel of distribution. A channel of distribution essentially enables the movement of products from the point of production to the point of consumption as well as the transfer of title from the manufacturer to the ultimate consumer. Looking at the market and the type of organizations engaged in the distribution of products, you would find that there are a wide variety of such organizations performing different kinds of distribution related functions, with varying terms of trade. Let us look at different types of intermediaries that if you may need to consider in order to form your own channel of distribution.

Broadly, all intermediaries can be divided into two categories: Agent middlemen and Merchant middlemen. The agent middlemen are brokers and commission agents who negotiate purchase and sale of goods on behalf of other parties for a certain percentage of commission. Because agent middlemen work on behalf of other parties they do not take title to goods. Quite a few new entrepreneurs find it useful to appoint agents when they first get into the business of producing value added food products to help them find appropriate clients and avenues of selling their products. If you are starting with a small operation and your production is not too large, agent middleman may not find it profitable to act on your behalf.

Merchant middlemen, on the other hand, are those intermediaries who buy the goods from the producers and then sell them on their own behalf. In other words, they take title and possession of goods in order to resell them further. The merchant middlemen can be of several types viz. wholesalers, retailers, cooperatives and supermarkets, multiple shops or chain stores and department stores. In order to establish your channel of distribution, you will need to decide a specific combination of these intermediaries. Let us look at the main functions performed by these intermediaries so that you can accordingly take your channel decision.

Wholesalers: The term wholesalers includes all establishments and businesses engaged in purchase of goods from the producers for the purpose of reselling them to retailers or industrial, commercial, institutional or professional users or to other wholesalers. The principal business of wholesalers is buying goods in bulk and reselling them for a profit to (a) retailers who then resell the goods to the final customers or (b) utilize the goods in the course of operating an enterprise or business. In performing the distribution related activities, the wholesalers perform the following functions:

- a) Taking possession of goods, maintaining storage facilities and maintaining adequate stocks in terms of both variety and quantity on a regular basis.
- b) Delivering goods to customers (You must appreciate that the customers of wholesalers are retailers, industrial or professional enterprises and other, smaller wholesalers).
- c) Taking ownership or title of goods from the producer and passing it on to the customer when the sale is made.
- d) Participating in promotional activities for trade promotion initiated by the producer.

- e) Negotiating on prices, terms of trade and terms of sale with both the producer and the customer.
- f) *Taking risks*: Risk taking is a major function performed by the wholesalers. By taking the ownership of the goods, they assume the risk of obsolescence, pilferage and damage to the goods as the goods are now owned by them. In the case of new untried products or unknown products they also take the risk of being left with stocks of unsold goods, if the goods are not accepted in the market.
- g) *Ordering*: The flow of ordering moves from the final consumers via retailers and wholesalers to the manufacturers. Wholesalers, order the supplies of goods from various manufacturers in anticipation of the order flow from the retailers and final customers.
- h) *Financing*: Wholesalers, by selling the goods on credit to the retailers and collecting the payment after an agreed time period, provide a vital financing support to the retailers.

Retailers: The term retailer includes all establishments and businesses engaged in selling goods for personal or household consumption. The distinction between the wholesalers and retailers is that the retailers sell primarily for ultimate use by the final consumer. You will find a variety of retail establishments existing in our country, ranging from consumer stores, multipurpose retail stores to sophisticated departmental stores. In terms of distribution activities, retailers perform the following functions:

- a) Taking possession of goods from wholesalers, maintaining storage and desired stocks in order to fulfil the requirements of the final consumer.
- b) Passing the delivery of the goods to the final consumer for price.
- c) Taking ownership from the wholesaler to retailer and passing it on to the final consumer.
- d) Participating in the promotion programmes of the manufacturer by organizing store displays and acting as final deliverers of sales promotion schemes directed at the final consumers.
- e) *Risk taking*: Like wholesalers, retailers also take the risk associated with ownership. Their risk in the case of unsold merchandise may be partially offset if the wholesaler or manufacturer agrees to accept the returned unsold stocks.
- f) *Information flow*: As they are in touch with the final consumer, retailers are a source of valuable information about the consumers' tastes and preferences, buying habits and paying capacities. Retailers participate in information flows backwards to the manufacturer so as to improve services to the final customer.

You would by now have noticed that the functions performed by the wholesalers and retailers are quite similar except for the fact that the scale of operations by wholesalers is much larger as they buy and sell in bulk for the purpose of reselling. The retailers, on the other hand, sell for the purpose of consumption by the final consumer. Their distribution related activities are directed mainly towards the ultimate consumer. There can be several types of

retail establishments as we have noted earlier, some of the common ones being departmental stores, cooperative stores and chain stores.

Departmental stores usually located at a central location, provide a great shopping convenience to the modern customer who is short of time, by providing them a range of products under one roof. Being able to attract a large number of customers they are able to manage a large turnover even though their margins maybe small. Their large size enables them to buy directly from the manufacturers and avail bulk discounts thereby saving the wholesalers' margins and passing the benefit on to the consumer in the form of lower prices. As a producer of value added products, you may consider departmental stores as an option because your products can get a large exposure to your target customers in such locations.

Cooperative stores or consumer cooperatives are run by societies formed by consumers themselves. The basic purpose of the cooperative store is to eliminate the middlemen and obtain the goods for their members at a low price. Like departmental stores, cooperative stores also obtain their supplies in bulk and enable the consumers to get the benefit of low selling prices. Some of the common examples of consumer cooperative stores are super bazaar and the Central Government Employees' Consumer Cooperatives.

Chain stores or multiple shop systems represent a concept where a number of stores are managed by one common ownership and management. The various stores can be located in different cities or at different locations in one large city. The chain stores usually deal in similar types of goods for example the Bata Shop, and the Phillips appliances shop. Food based chain stores are becoming very common in metropolitan cities, named as food bazaars or food courts. They have become a good outlet for the introduction of new food products and availing a larger variety of food products in one location. Such food bazaars may be a good outlet for the value added food products for you to consider.

Haats and weekly markets: Rural consumers, on account of the absence of organized markets in the villages, carry out a lot of their buying activity at haats and weekly markets held around their villages. As the purchasing power of the rural customers has grown, marketers have found that these weekly markets provide a lot of access to a large number of customers in the non-urban markets. You must realize that the rural market in India is a large one, with high potential for development. Though the market for value added food products may at present be very limited, the potential for developing this market cannot be ignored.

Activity 2

Make a visit to the following types of retail outlets in your locality:

- A. A super bazaar or cooperative store.
- B. A departmental store.
- C. A general provision store in your own colony.
- D. A weekly market organized near your colony.

Make a list of the type of value added food products you find at these retail establishments. How do you think your own proposed value added food products will fit into the product assortment being offered by these stores? Which type of retail outlets will be most suitable for your value added food product and why?

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13.4 IMPLICATIONS OF USING INTERMEDIARIES: CHANNEL LEVELS

By selecting an appropriate channel, you as a producer of value added products are trying to bridge the gap between you and your final consumers. Now that you have looked at different types of intermediaries operating in the market place, you can decide in terms of the levels or the number of channel intermediaries you want to mobilize to reach the final customers. Your choice would be strongly dependent on the market coverage you want and the scale at which you want to operate. Since you are a producer of consumer goods, the following channel options are available to you as diagrammatically shown in the figure below:

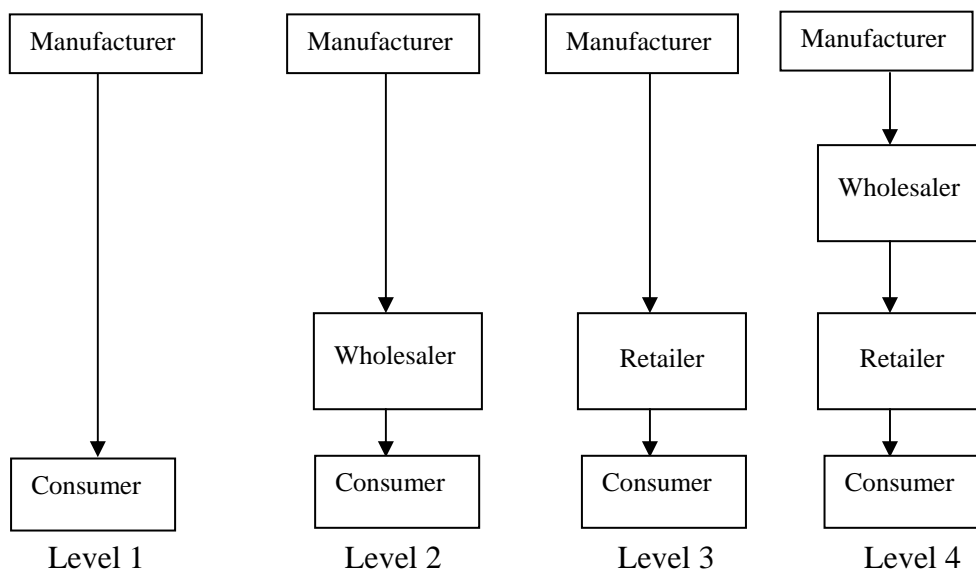


Fig.13.1: Levels of intermediaries

Level 1 represents the direct distribution situation explained earlier in section 13.2; where you choose to sell directly to your customers without using any intermediaries. Levels 2 and 3 represent situations where the manufacturer chooses to sell through wholesalers or retailers directly to a large number of consumers. Level 4 represents multilevel distribution situation where owing to the large market coverage desired, the manufacturer accesses the market

through a network of wholesalers who then sell to their respective network of retailers. The retailers then reach out to the final consumers in their respective areas.

13.5 SELECTING AN APPROPRIATE CHANNEL

The channel selection decision is one of the most important decisions that you would be required to take. This is on account of two reasons. One, channel decisions bind you in relatively long term commitments which are usually difficult to undo. Secondly, the costs involved in distribution affect the final price the customers are to pay and therefore, has a bearing on the type of market you will be able to attract at that price. The channel decisions also strongly affect your promotion, pricing and product line extension decisions. These decisions therefore, are taken after a lot of deliberation and consideration. The selection of an appropriate channel design would depend upon:

- a) *The market coverage desired:* Your choice of channel design is strongly dependent upon whether you want to operate in the local market only or you desire to operate in regional and national markets as well. As your intended coverage grows, it is difficult and uneconomical to operate only through your own direct channels. Level 3 or level 4 channel systems become more prevalent as the market coverage desired by an entrepreneur grows to regional or national markets.
- b) *The resources available at your disposal for production and marketing:* In the initial years, your capacity and resources to produce large quantities of value added products and to market them effectively is rather limited. Direct distribution or shorter channel systems (level 1 or levels 2) to distribute the limited lot sizes being produced by you are more suitable in such circumstances. As the market acceptance grows, entrepreneurs find it more economical to use longer and multilevel channel systems.
- c) *The cost of distribution:* In respect of each of the channel systems that you want to use is an important criterion of selection between channel alternatives. As distribution costs form a large percentage of the total cost of goods sold, comparison of different combination of participants in channel systems and the total cost each alternative system should be carried out once you have decided to use intermediaries for the distribution of your value added products.
- d) *The type of services that the intermediaries are able to provide to you:* Intermediaries differ in the extent and types of services they are willing to offer to the entrepreneurs. These services range from promotional support to favourable shelf space, refrigeration facilities, cold storage facilities, warehousing, credit support to retailers by wholesalers etc. Depending upon the requirements of your product and marketing effort, you may like to select the channel alternative that best complements your product and marketing needs.
- e) *The nature of the product and its shelf life:* Product characteristics often become the starting point in your search for suitable channel alternatives. The nature of the product in terms of its perishability, packaging requirements, shelf life, type of handling required etc are important determinants of what kind of channels or intermediary partners would be

most suitable to you . For example, if your value added products are jams or jellies which need to be sold in glass bottles and have a shelf life of about three months, you can afford to be more flexible in your choice of intermediaries but if you are dealing in fruit juices packaged in tetra packs, your choice would be restricted to channel members who can provide refrigeration facilities to ensure that the product to reach the customers in an unspoiled and fresh condition. Similarly, in the cases of products which are equally substitutable by similar competitive products, and have low brand loyalty, entrepreneurs have to resort to intensive distribution to ensure that the consumer does not switch to a competitive product on account of non-availability to their brands.

- f) *Buying habits of the customers:* Every marketer needs to study the buying habits of the customers in terms of their shopping preferences, store selection, volume of purchase and frequency of buying. Preferred store choices for food products would be a key input in your choice of the retail level outlets because a new product would get maximum exposure to consumers if it is placed in the outlets frequented by them.
- g) *The trade practices followed by your competitors:* When you are in a competitive business like marketing of value added food products, you cannot afford not to be present where your competitor is present in the store outlets, neighbourhood shops, or periodic markets like haats and weekly bazaars. On the other hand, if there are some markets which are overly occupied by a competition, as a new entrant you may find it easier to access other markets where the intensity of competition is lower. In either case, your choice of intermediaries is dictated by the trade practices followed by your competitors.

Typically as new organizations, small firms begin to sell through getting themselves accepted by the existing intermediaries in the local markets; beginning from a limited market access, and by gradually capturing larger markets by diversifying their channel options. You may find that as a new entrepreneur, your problem is often not of selecting appropriate channels but that of being selected by existing intermediaries. Wholesalers and retailers also take the risk when they agree to stock and sell products from unknown new manufacturers especially when the products are eatables like value added food products. You may find that in the initial years you may not have too much of a choice in the selection of your intermediaries. As you get established in the market and your brand starts getting accepted by the consumers, your discretion and flexibility in choosing your own intermediaries will increase.

Motivating the channel members: Once the channel members have been selected and a distribution channel put in place, every manufacturer expects the channel members to provide the best possible support to his products and brands. You would appreciate however that while business from you may be important to the channel intermediary, yours is just one of the brands that he carries. Intermediaries are independent businessmen, engaged in providing distribution support to the manufacturers in lieu of the margins that they can earn from distribution of goods to the final customer. At any given point of time they need to cater to a large number of manufacturers in the same product category, most of them competitors to each other. As an entrepreneur, therefore you would often find that you may need to motivate the channel participants so that there is no laxity in their efforts to push your brands and to

create the desired awareness at the point of sale especially when your brand is new. Several approaches are followed by the manufacturers, chief among them being the cooperative approach where the entrepreneur and the channel members get into an agreement whereby the entrepreneur agrees to provide promotional support and assistance, the display materials and equipment if any, commission on extra sales in return for extra efforts by channel members in pushing his products. Use of power, granting of exclusive selling rights, attractive sales promotion schemes directed at the intermediaries, dealer contests etc. are other approaches that used to keep the channel members motivated.

Whether you are conducting your distribution function yourself or following the indirect distribution alternatives through wholesalers and retailers; it is a good idea for you to define the outputs that you want from your distribution network in terms of the service levels that you want to offer to your customers. These outputs could be defined in terms of timeliness of delivery, freshness of stock, information on product and product line, maintenance of complete product line, prevention of stock out conditions etc. Defining these outputs in physical terms will enable you to measure the performance of the distribution effort.

Activity 3

Visit some retail outlets selling value added food products. For the different categories of food products, find out the commission being charged by the retailers from the manufacturers. Also discuss with them to find out the various kinds of support that is being provided by the manufacturer for these products in terms of promotional material, sales display support, sales promotion schemes etc. How in your view the commission given and the support provided affect the selling efforts of the intermediaries?

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**13.6 PHYSICAL DISTRIBUTION TASKS: DISTRIBUTION
ACTIVITIES AND LOGISTICS**

The physical movement of finished products from the point of production to the point of consumption and the associated decisions of maintenance and movement of stocks, handling of material and transportation are included in the physical distribution function, is often called the market logistics function. Physical distribution is an important area of decision making for entrepreneurs who are shocked to often find that it can amount to 30 to 40 percent of the total product cost. Poor functioning of physical distribution activities can lead you to lose customers if you fail to supply goods on time, and create situations where your money is tied up in unsold stocks. The various decisions that you will need to take as a manufacturer of value added food products within the Physical distribution function are the following:

- *Order processing decisions:* The order processing system defines the way your order- to- payment cycle is planned i.e. what is the processing system you would like to put in place once an order is received to the stage where payment for the supply of the order is received. This process may include several steps, from receiving in order to filing it, checking it against available inventory, putting a production schedule in operation if it is a large order, order and invoice shipment, information to the customer for and collection of payment. In case you are selling through the intermediaries, your orders would be received from the intermediaries and the payments in turn would be received from them. Computerization of inventory processes and an order tracking system help in cutting down the order- to- payment cycle considerably and help in saving costs as well as improving the efficiency of the system.
- *Warehousing decisions:* You will find that as a manufacturer of value added products, because of the gap between the time of production and the time of consumption you would need to store finished goods until they are sold. Depending upon whether you are selling only in the local markets or in regional or national markets, you will need to decide on the number and location of warehouses or stocking places where finished goods can be stocked till they are ordered and sold. Small entrepreneurs usually hire space in public warehouses rather than building up their own warehouses. While on one hand more stocking locations mean that that the delivery time to customers will be shorter, it also means that the inventory costs and the warehousing costs would be higher. You could alternatively choose to have a single warehousing location centrally and use quicker transportation modes to deliver the shipments to your various customers.
- *Inventory decisions:* Inventory decisions are important because they represent major cost component of the total cost of distribution. Your inventory decisions include decisions on when to stock and how much to stock of each item. The manufacturers would like the distributors or stocking locations to hold enough stocks of all their value added food products so that the customer orders can be promptly fulfilled. If it is, however, found that holding sufficient stocks of all the items in the product line at all locations is not cost effective. Depending upon the different levels of demand for different items of the product line at different locations in the market, economic order quantities and reorder points are worked out so that overall inventory costs can be minimized.
- *Transportation decisions:* Since goods need to be physically transferred from the point of production to the point of consumption or demand, one of the important physical distribution decisions is that of selecting the

mode of transport. In trying to transport your value added food products to your warehouses, your dealers or large customers, if you will be faced with a variety of options like trucks, railways, container services, waterways and airways. The criteria used to selection include cost, speed, reliability, availability and possibility of tracking in- transit information, depending upon their own product based needs, requirements of timeliness of delivery and the weightage they wish to assign to the other criteria, entrepreneurs make their transportation mode selections.

13.7 ISSUES IN THE PHYSICAL DISTRIBUTION PROCESS

There are certain issues that you may need to consider, while taking your physical distribution decisions. Some of the important issues are discussed below:

- The physical distribution objective is often defined as making the goods available in all the places that they are desired in the least possible time at the lowest possible cost. While this looks good on paper, it is something almost impossible to achieve. If you want to make goods available in all possible places where they are needed, and do so in the least possible time you would find that the cost of fast distribution is indeed and not the lowest cost. You will, therefore, have to choose the type of speed of delivery that you desire at the costs that you can afford.
- You will find that there is a certain inter-relationship among the various components of the physical distribution process. A faster transportation mode would mean higher costs of transportation but may result in lower inventory costs. Similarly, higher costs of warehousing may result in lower transportation costs but mean higher inventory costs. Trade offs are therefore, available between different components within the physical distribution function .The relevant cost to look for therefore, is the overall physical distribution cost rather than clicking to minimize the cost of individual components of the physical distribution function.
- In addition to the criteria of cost and timeliness of delivery based on the nature of your product, to which in this case is of semi perishable nature, you may also need to consider competitive criteria- what are the speed and delivery parameters that are being used by the other manufacturers in this business. These parameters sometimes define the trade practice in a given trade



13.8 LET US SUM UP

Distribution performs the vital function of linking the manufacturers with their consumers, by making the goods available at the time at which they are needed by the consumers and at the places at which they are needed. As a manufacturer of value added food products, an entrepreneur has the choice of undertaking the various tasks of distribution himself (Direct distribution) or identifying a suitable combination of intermediaries like wholesalers agents for retailers who will undertake the distribution function for this products in return for the trade commission(indirect distribution). The choice of a suitable channel structure depends upon criteria like the nature of the product, cost, competition, the type of market coverage desired etc. The entrepreneur,

in addition, has to decide upon the various components of the physical distribution aspects which include order processing, warehousing, inventory decisions and transportation selection. These decisions are important and need to be taken with serious consideration as physical distribution forms a significant proportion of the total cost of distribution. In this unit you have been exposed to the need and scope of the distribution function, the factors affecting choice between direct and indirect distribution, types of intermediaries and their functions as well as the levels of channels. You have also been exposed to the decisions and issues involved sell for Sussman in the physical distribution function.

13.9 KEY WORDS

Direct distribution : The distribution situation where the entrepreneur chooses to undertake all the distributions functions by himself and sell directly to his customers without involving any intermediaries.

Indirect distribution : The distribution situation where the entrepreneur chooses to sell his value added food products through a network of wholesalers, retailers or agents or a combination of one or more of these intermediaries to form a channel of distribution to reach his customers.

Channel of distribution : A combination of institutions which perform all the activities needed to move a product and its ownership from the point of production to the point of consumption.

Wholesaler : The intermediary who buys from the manufacturer in bulk for the purpose of reselling to the retailers.

Retailer : The intermediary who buys from the wholesalers or directly from the manufacturer for the purpose of selling directly to the consumers.

Physical distribution : The function involved with physical movement of finished goods from the point of production to the point of consumption.

13.10 SELF ASSESSMENT QUESTIONS

1. For the list of products given below, suggest whether direct or indirect distribution channels would be appropriate. Give reasons for your answer.
 - a) Fresh fruit juice
 - b) Packaged or tinned fruit juice
 - c) Jams, jellies or marmalade
 - d) Vegetables preserves

- e) Pickles
 - f) Packaged ready to eat vegetables
 - g) Soup powders
2. As an entrepreneur you have developed a line of fruit based products to suit the health requirements of the present generation. These include a complete range of fruit juices, preserves, jams and jellies without artificial sweeteners or extra sugar. As chemical preservatives have not been used the products have a relatively short shelf life. What are the criteria that you would apply to select appropriate channels for your product line?
 3. What are the important decisions within the physical distribution function that an entrepreneur dealing in value added food products will need to take? Explain with the help of suitable examples

13.11 SOME USEFUL BOOKS

1. Barrow, Colin (2000). “The Essence of Small Business” PHI Essence Series.
2. Kotler, Philip (2003). Marketing Management, Eleventh edition, PHI.
3. MS-06 (2003). Marketing for Managers, Block 6 – Distribution Public Policy, IGNOU.

UNIT 14 UNDERSTANDING AND MANAGING PROMOTION

Structure

- 14.0 Objectives
- 14.1 Introduction
- 14.2 What is Promotion and How Advertising Works?
- 14.3 Components of the Promotion Mix
- 14.4 Deciding upon the Promotion Mix
- 14.5 Setting Advertising Objectives
- 14.6 Deciding upon the Promotional Budget
- 14.7 Selecting Appropriate Advertising Message
- 14.8 Selecting Suitable Media
- 14.9 Coordinating with Advertising Agency
- 14.10 Role of Publicity in Promotion
- 14.11 Role of Personal Selling
- 14.12 Role of Sales Promotion
- 14.13 Evaluating the Effectiveness of Your Promotional Effort
- 14.14 Let Us Sum Up
- 14.15 Self Assessment Questions

14.0 OBJECTIVES

After studying this unit, you should be able to:

- discuss the role of promotion in effective marketing of value added products;
- describe the components of the promotion mix;
- decide upon the components that you should use in your promotion effort;
- set up your promotion budgets;
- develop appropriate advertising for your products;
- identify suitable media for your advertising; and
- evaluate your promotion effort.

14.1 INTRODUCTION

Once you have identified what you intend to produce, you also would need to inform the potential customer about the existence and availability of your product, interest them in your product through information about the features of the product, and give them a reason to buy. The entire function of informing the potential and existing market about your offerings, encouraging them to buy your products is referred to as promotion. Promotion is one of the most important elements in the marketing mix. It encompasses all the means of communication with the customers. In accordance with your target market, you need to decide who should inform about the product and what should you tell them. Also, how should you reach these people who may be your potential customers. Promotion is important because it contributes to the consumers' knowledge about the various products available in the market and makes it easier for them to make informed decisions. Promotion is also important

because it establishes your product image and brand in the mind of the customer and facilitates the process of remembering and recalling the brand name at the time of decision making. Promotion enables consumers to understand the differences between different product offers and allows you to create an identity distinct from your competitors. For the consumers, it helps them to understand how one brand is different from others, so that they can choose something which most ideally suits their requirements.

14.2 WHAT IS PROMOTION AND HOW ADVERTISING WORKS?

All the processes used by the manufacturers to influence the customer in favour of their products by various means of communication are collectively termed as promotion. Essentially, all products are solutions to the needs of the consumers. At any given time, however, there are several alternative solutions that the customers may have for a given need. The different brands of value added products represent the alternative solutions that the customers may like to choose from. As a marketer, you would need to tell the potential benefits of your product over other competing products. The promotional efforts undertaken by the small entrepreneur can take the form of advertising, publicity, sales promotion or personal selling or a combination of two or more of these. Together these functions constitute the promotion mix for an organisation. Let us try to understand how promotion works.

1. *Creating awareness:* The primary task of promotion or advertising is to create awareness of the product in question for the purpose of increasing the likelihood of purchase of value added products being contemplated by your potential customers. For a new product the marketer's challenge is to create the recognition of the brand name, with simple messages and building recognition of the name over time.
2. *Build knowledge:* Not only is it important for consumer to know your product name, but it is also required that they know what are the features of the product. For example, that it is a quality product with natural ingredients and with no chemical preservatives. Only on the basis of what they know about the product, your consumers will be able to distinguish it from the other products on offer, and decide whether the product would suit their requirements.
3. *Creating liking:* It is the job of the marketer to find out what their potential consumers like in products like jam, marmalade, pickles or juices, incorporate them in the products and then highlight the same in the promotion.
4. *Building preference:* Due to their exposure to your promotion some of the consumers may like the product, but still not prefer it to others. The promotional process, by highlighting features like quality, freshness, taste purity and standardisation of process, attempts to develop a preference for the advertised or promoted product.
5. *Creating conviction:* Through reinforcing the product superiority and making sure the product fulfils the promise created through

communication, promotion also seeks to build up conviction among the target audience over a period of time. You must therefore ensure that the promotion undertaken by you is believable and credible.

- 6. *Promoting purchase:* Finally, by giving consumers a reason to buy now, or buy a larger quantity or undertake a product trial, either by giving an introductory offer by a promotional discount or a quantity discount promotion aims at influencing purchase of the product.

The above model of how promotion works is called the hierarchy of efforts model. According to another, popular model the AIDA model, promotion works by attracting attention, creating interest, initiating desire and finally buying action.

Activity 1

Make a list of 3 popular brands of juices and fruit preserves. Taking the list with you, ask at least 10 consumers how they first came to know about each brand. Try to learn what they know about the brands, even if they are not using the brand Study this information. What does the information tell you about the role of promotion?

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14.3 COMPONENTS OF THE PROMOTION MIX

In your daily life you are exposed to a variety of promotional efforts by organisations television commercials and print ads, billboards on the road, employment announcements in the paper, ‘sale’ and discount offers, promotional fliers in your letter box or your e-mail and sales persons knocking at your door are all examples of the promotional efforts being made by the marketers to inform, create awareness, build up preferences and ultimately promote the purchase of their products. To understand different forms of promotion, so that you can utilize them effectively for your own promotional activity, let us define the various components of the promotion mix. As noted earlier, the promotion mix consists of four components i.e. advertising, personal selling, sales promotion and publicity. Each is explained below:

Advertising: It is any paid form of non-personal, mass presentation and promotion of ideas, goods, services by a known sponsor. Advertising may be through any media like newspapers, magazines, posters, bill boards, handbills, television and radio commercials, cinema commercials, direct mailers and e-mail based mailers, catalogues and message on buses, trams, trains etc. Depending upon your budget and the type of audience you want to reach, you may select any combination of forms of the media described above. One basic

purpose of advertising is to increase the possibility of purchase and this is sought to be accomplished by imparting information, developing brand awareness and belief, developing favourable attitudes and to influence buying action. You as the marketer would like to inform your potential customers of the availability, prices and the benefits associated with your product so that this information facilitates their selection between various brands. In addition to this basic purpose, you may also use advertising for

- a) to announce a special promotion scheme
- b) to counteract moves made by your competitors
- c) to build up motivation of the retailers to sell your product
- d) to encourage and build up the morale of your sales team
- e) to build up the image of your company.

Personal selling: In contrast to non-personal mass promotion (i.e. advertising), personal selling is person to person communication between the potential buyer and the seller. It is the oral presentation or oral presentation supported by other media like reports or audio visual slides to one or more potential buyers for the purpose of making a sale. Personal selling as a mode is more flexible than advertising because the salesman can mould his method of presentation and persuasion according to the needs of the customers that he is facing at a given time. In addition to persuading people to buy, personal selling can be used to perform the following functions:

- a) Booking orders
- b) Generating inquiries about the product
- c) Answering consumers queries about the use and attributes of the product
- d) Price negotiation
- e) Collection of payment
- f) Collecting market information about customers, competitors and dealers.

Because personal selling uses personal contact as a mode of communication, this is also one of the most expensive methods of promotion specially for low unit value products.

Sales promotion: All marketing activities, other than personal selling, advertising and publicity that are used to stimulate consumer buying and dealer motivation such as incentives, sales displays, shows and exhibitions, coupons, contests, discounts, free sample offers and gift schemes and other non-routine selling activities are included in sales promotion. The purpose of sales promotion is to stimulate the sale of a product by offering some specific incentives which may be directed either at the consumers or the traders. You may also create incentives directed at your own salesmen, stimulating them to sell higher quantities of the product. Generally sales promotion offers give customers a reason to buy now, as the offers are open for a limited period of time. They perform the function of creating an immediate interest and inducing trial of the product. The marketer hopes that once the consumer has tried the product, he will stay with the product since the product is good. There are several types of sales promotion tools. The tools directed at the customer include:

- a) Price discounts for a specific period or for a certain package size.
- b) Free samples or Subsidised samples.

- c) Pack in premium – which is a free gift along with the pack.
- d) Quantity offer which allows people to buy extra quantity at no extra cost.
- e) Coupons which allow consumers a saving on next purchase or a cash refund.
- f) Contests which encourage consumers to enter contest and benefit through games or schemes.

Marketers also use sales promotion directed at their wholesalers and retailers to encourage them to stock sufficient quantities of the product and put in special efforts to sell the product. These sales promotion tools include quantity discounts, display materials, allowances for local advertising, dealer contests and gifts etc.

Publicity: Publicity is defined as non-personal stimulation of demand for a product, service business by generating commercially significant news about it in published media or getting favourable presentation on public media like radio or television. This form of promotion is not by an identified sponsor and is also not paid for by the sponsor.

Today, other elements of the marketing mix are also used as promotional tools. Packaging is an important tool of promotion which can, through distinctive colouring and designing become a special aid in brand recognition and identification. Information on the package and label can play a useful role in creating consumer awareness and knowledge. Attractive package design can stimulate consumer interest. Reusable packages like glass jars and pet bottles add to utility value of the product and add another incentive to purchase.

Public relation, the function of maintaining good relations with general public, customers, press and society at large can contribute to the promotional activity by establishing a favourable image of your organisation.

All these elements together constitute the promotion mix for an organisation. You would need to decide which element or combination of elements you would like to use for your own products, keeping in mind the costs to be incurred, the need for creating awareness and interest and the specific objectives you want to attain through the promotional effort. In the next section, we would discuss the considerations you must keep in mind for deciding on your promotion mix.

Activity 2

Take the example of a few value added products like

- a) Branded masala blends (Chat masala, Chana masala etc.)
- b) Squashes
- c) Fruit juice concentrate

Go through the various media like radio, television and newspapers and identify the types of promotion that is being used for each of these categories. Prepare a brief note on the same, why do you think these elements have been included in the promotion mix?

14.4 DECIDING UPON THE PROMOTION MIX

While attempting activity 2, you would have noted that marketers seldom use only a single element in their promotional efforts. They usually utilize a combination of four elements, depending upon their marketing objectives and resources. If you consider a sample product like Maggie, Noodles, you will find that a combination of television and print advertising, displays in shops, danglers and bill boards, gift schemes and quantity discounts is being used to promote the product. Several considerations affect the type of promotion tools that would be required for a particular product. Let us look at these considerations:

1. *Product considerations:* The type of promotion task to be formed is strongly influenced by the type of product involved. For a low priced, repetitively purchased item like toothpaste or food products, the promotional message would need to be repeated frequently so that consumers are reminded. It would need to reach a large number of consumers so that new consumers can be attracted to the product. As large number of potential customers have to be addressed, person to person methods like personal selling would be unsuitable. You would require elements like advertising and sales promotion to address your promotion needs, newspapers, handbills, posters, free samples radio spots and if you can afford audio visual ads are sources of the alternative you may consider.
2. *Market consideration:* The choice of elements in your promotion mix will also depend upon where your customers are located, are they very widely dispersed, how many target customers do you want to reach, is your target area local, regional or national? How many competitors are already operating in the market place and what are the ways they have chosen to communicate with the consumers? When the target consumer groups are both poor and distributed over a vast geographical area, advertising and sales promotion are more economical and cost effective; as the cost of reach per customer is low. You will find that while personal selling plays a more central role in cultivating customer for industrial goods and even for consumer durable goods, for non-durable low price per unit consumer goods like value added food products, the role of personal selling often gets limited to servicing the wholesalers and retailers.
3. *Resources available:* As an entrepreneur, you would need to set aside resources for promotion. The money you decide to allocate for promotion constitutes your promotional budget. Each of the alternatives studied by you, has its own cost. The extent to which you want to use each element, and the number of elements you want to use at a given point of time, depend upon the size of promotion budget that you have decided for the effect. You will realise that initially your relatively modest budget may allow you only to have localized advertising in the vernacular press, distribution of handbills and displays at the retailer shops. As you grow and develop and are able to assign higher budgets, your choice of elements and the extent to which you want to use them widens.

Product life cycle consideration: All products go through a life cycle of introduction, growth, maturity, saturation and decline. The duration of the stages and the time taken to attain the next stage varies widely with the type of

market and the type of marketing strategies applied by the marketers. At each stage, the role of promotion differs. At the introductory and early group promotion has the role of informing the potential customers, creating maximum awareness and building up an interest in the product. The promoting task would require lots of publicity, consumer sales promotion through samples and introductory discounts, informative and creative advertising and promotion directed at the trade. During the late growth and maturity stage, informative advertising is not required, your advertising would be targeted at sustaining consumer preference and building brand loyalty. Looking at your marketing objectives framed, development, growth, stabilisation and survival at different points in the life cycle of your product, you will need to vary the composition of your promotion mix.

Activity 3

Select 5 value added products one each in the product life cycle stages described above. Carefully study the promotional efforts used by them and identify what are the tools used at each stage? Can you reason why this variation exists?

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14.5 SETTING THE ADVERTISING OBJECTIVES

A large number of users of advertising feel that the ultimate objective of advertising is to sell. Advertising seeks to do this through persuasive communication, creating awareness building familiarity and brand recognition and informing consumers from time to time about the comparative advantages of your product over other competing products. Advertising thus has both communication and sales objectives. At any given point of time you may choose to assign more than one communication and sales objectives to your advertising activity. However, for focused effort and effectiveness; it is advisable to define objectives as measurable goals. This is referred to as the DAGMAR approach (defining advertising goals for measured advertising results). The approach suggests that advertising goals should be defined as specific and well defined communication tasks, in measurable terms, which should be stated to be achieved within a specific time period, with respect to a particular set of customers. For your own potential customers, for example, advertising goals could be defined as “to create awareness levels of my brand of Jams and Jellies from the present 0% levels to about 20% among 50% of the target customers in the city of Nagpur and Aurangabad within the next 3 months”.

You would appreciate and that when you are about to start your business, the main objective of advertising would be informing your target customers about your products and their features. At the initial stages of the business advertising is designed to create a business and knowledge of your range of products among potential customers. Advertising is essentially a persuasive communication and another objective that is used in the initial stages is to build up the liking, preference and belief in the product and its characteristic in order to motivate customers to initiate purchase. At the later stages when there are several competitors for your products, the objective of advertising would be to compare your product favourably with those of the competitors and getting the customers to learn how to differentiate between your product and the competitors' product. This is known as comparative advertising and the focus is to show the comparison, the advantages of the advertised product over its closest competitors.

Once the product has been accepted in the market, advertising is used to remind people again and again (Reminder advertising) so that the product may remain in the memory of consumers and promote repeat purchases. At subsequent stages in the product life cycle when your objective is to retain the customer your advertising should take the form of reinforcement advertising, and because your goal is to convince the customer that he has indeed made the wise choice by selecting your product.

Your selection of the advertising goals should clearly reflect a clear understanding of your current market situation. If you are in a competitive market and are introducing a new product, the advertising aim would obviously be to create market awareness and give your customer a reason to buy. If you find that the product is getting established but the usage is low then your advertising objectives should be directed at increasing usage.

Your promotional activity is an investment in establishing you in the market by getting you to become known and bringing in the required sales. In order to maximize this investment however you need to be very clear about what exactly you want your advertising to do for you. This clarity will help you in directing your advertising investment towards yielding the most profitable results.

To summarize the objective of the promotion exercise for popularizing your value added products could be the following:

- To inform the market and build awareness of your products.
- To create brand knowledge and help the consumers to differentiate your products.
- To reinforce the positive attitude about your products.
- To motivate consumers to take buying action.
- To build up interest among the dealers and retailers to carry your product.
- To build the image and recall of your product.

How does a small business decide how much to spend on promotion? As you have just noted, advertising and promotion are your investments in establishing you in the market. You must set a promotional budget based on your own resources and the objectives of the promotional activity that you have decided for yourself. Some of the methods of deciding promotional budgets used by small businesses include the following:

The affordable method: Small businessmen using this method base their budget on whatever they can afford at a given point of time. While this method is simple, it ignores the reality that when you plan to set up a business to make and market value added products. Your resources are often limited and basing a decision on what you can afford can often leave you with very meagre resources for promotion; whereas your requirements for spending on promotion may be very high because you are new to the market.

Competitive parity method: Some people try to take what their competitors are spending for their own promotion and make this a basis for deciding on their promotional budgets.

Objective and task method: This method allows you to estimate the size of your promotional budget by looking at the tasks and objectives that you have kept for your promotional activity. This method has the advantage that it allows you to adapt your promotion budget according to the tasks that you have assigned to your promotional activity at any given point of time. This is among the most rational methods of arriving at your promotional budget.

Fixed sum per unit method: Under this method the promotional budget is determined by the allocation of fixed rupee amount per unit of product, depending upon the expectation of future sales of the product. This method is also easy to calculate but is arbitrary because it does not take into account the variations needed under given competitive or market circumstances.

Percentage of sales method: In the case of an ongoing business activity, promotional budgets are often decided on the basis of a fixed percentage of sales that you may like to set aside for promotional activity. For example, if you are selling vegetable soup concentrate and your targeted sale for the year is Rs. 2 Lacs, you may decide to spend 5% of your sales for your promotional activities which will give you a budget of Rs. ten thousand. This method also has the advantage of being simple. If you are selling a number of value added products, this five percent may be used as a general guideline for arriving at the promotional budgets for different products, or your overall sales figures may be used as the basis of the total promotional budget for your entire product line. This budgeting method has the advantage of being simple to calculate and easy to administer, but it ignores the market realities and specific requirements that a particular product may have, which may require a different kind of budget than suggested by a standard percentage of sales.

Activity 4

Assume that you are planning to enter the market with a product line of fresh fruit juices and tinned fruit slices. While the fresh fruit juices have a very competitive market, the fruit slices are a relatively new product and there are no major producers in the market. Looking at the methods that you have just studied, how will you decide upon your promotional budget? Identify the method you use and suggest why?

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14.7 SELECTING APPROPRIATE ADVERTISING MESSAGE

The primary purpose of advertising is to help sell your products. Any promotional activity which does not bring the customer nearer to the act of buying is a waste of money. Through your promotion, you should be able to offer a distinctive and attractive proposition by which you can attract your customers to pay attention to what you are saying and ultimately to buy your product. This proposition is called the unique selling proposition (USP) in advertising language. It represents a specific proposition which is distinctive and gives unique information about the attributes of your product which can pull the customers to the advertised product. In the case of value added products, the USP could relate to:

- The freshness of the product.
- The non-use of chemical preservatives.
- The purity of ingredients used.
- The unique flavours developed by you.
- The tamper-proof packaging being offered.
- The unique taste offered by you.
- The pricing advantage offered to the customers.
- Or anything about the product which gives you a uniqueness or a distinctive advantage over your competitors.

In addition, the message in the promotion should be presented in a way that it is able to attract the potential customers to go through the message and help them remember the features of the product. Use of simple language, interesting headlines and attractive visuals showing the product, go a long way in creating effective messages.

14.8 SELECTING SUITABLE MEDIA

There are a variety of media options available for you to take your message across to your targeted customers. Newspapers, radio, television and billboards are some of the most common media used while selecting your media, you should have a clear idea of the media habits of your potential customers – Do they watch Television or listen to the radio and which papers do they read, (most of the literate)? The other factors you would need to consider include the cost of the medium, the reach of the medium, availability of the medium and suitability to your message design. For value added food products, you may like to consider the following media, described below along with their chief characteristics:

Press (including all types of newspaper and magazines): Wide circulation, limited life, is good for mass circulation and reminder messages. You could initially choose local newspapers to cut down on your initial costs and later expand to more regional or national press.

Door to door distribution of pamphlets: Controllable circulation, limited life, and inexpensive and flexible usage are good for mass circulation. These pamphlets can be manually distributed or inserted along with newspapers, with a commission paid to the distribution agents of newspapers.

Direct mail: Restricted circulation, flexible usage and high impact, need prior identification of potential customers. This medium is used by sending promotional letters to identified customers, and is usually applied for high value added customized products.

Outdoor media: Localized circulation is relatively durable and inexpensive and good value reminder as media. Outdoor media include holdings, billboards, posters, neon signs, display cards on buses etc. and wall writings.

Radio: It has wide reach, accessibility across literacy barriers, high flexibility and possibility of quick reminders within no possibility of visual demonstration. On account of its wide reach, radio gives among the lowest cost per listener and is a popular medium among small and new entrepreneurs.

Television: Combines the advantages of both audio and video but expensive medium with limited reach and high degree of viewer involvement. It is very suitable for product demonstration.

Cinema: Reach is limited to the cinema going population not all of whom maybe your potential customers. It reaches literate, neo literate, and illiterate audience.

Miscellaneous media: Media like exhibitions, fairs, haats and weekly bazaars offer good opportunities for promoting low unit value products like value added fruit and vegetable products.

For promoting your value added food products, you can select one or a combination of some of the above media on the basis of their effectiveness in reaching your promotion messages to your target audience. Due to the cost constraints, some of the expensive media like television or national dailies

maybe unaffordable at the initial stages of the business. In fact, if in the initial stages you are catering primarily to the local markets, more localized media like outdoor media, pamphlets, local bazaars and radio may be more suitable as your media choices to begin with.

14.9 COORDINATING WITH THE ADVERTISING AGENCY

As you would have realized, most of the promotional activity is a specialized one. It is therefore, advisable to engage an advertising agency to design and release your advertisements and organise other promotion as per your requirements. An advertising agency is an independent business organization comprising creative and business people to design, develop, prepare and place advertisements in media for their clients seeking to find customers for their products. Copy writing for ads, buying media space, planning media schedules, conducting marketing research to know the consumers better, public relations etc are all highly specialized activities, and are better left to specialized functionaries in the agency itself.

In order to get the best work out of the agency; you need to work closely with the agency. It is a good practice to get your requirements and ideas regarding your product and the way you want them to be promoted, across very clearly during the first meeting with the agency. At the initial stage you may have to set aside a lot of time and information to help the agency to have a complete understanding of your business, your marketing targets and the precise way in which you want your products to be presented to the customers. Usually the work of a specific client is entrusted to a given executive called the account manager for, who handles all the activities related to that account. It helps if close communication can be setup with this account manager so that your coordination with the agency can be easy and effective.

14.10 ROLE OF PUBLICITY IN PROMOTION

As noted earlier in the beginning of this unit, publicity is the non-personal stimulation of demand for a product or business unit by placing commercially significant news about it in a published medium or by obtaining a favourable presentation on it on radio, television or stage, which is not paid for by the sponsor of the promotion.

Publicity is essentially aimed at building up a favourable image, creating goodwill and getting a positive visibility which helps the business in its marketing efforts. Publicity is specially useful in creating a favourable information dissemination about new products, special features introduced, special R&D efforts made in value addition, promotion of new trademarks and brand images.

Publicity is also used to counter any misinformation misgiving or negative information in the market about a particular product or a brand or the business. As publicity is not paid for, and is seen to emanate from a neutral and impartial source, it can be an extremely powerful tool and should be used carefully for maximum impact.

Activity 5

Identify, by reading newspapers or magazines some publicity releases about value added food products. Explain how the printed material which has come out as an article on news item would help the product in question.

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14.11 ROLE OF PERSONAL SELLING

While advertising and publicity are impersonal methods of mass communication, personal selling uses face to face personal communication with target customers. As a manufacturer of value added food products, you may need to personally convince large dealers and big retailers to carry your product line. The scope of the personal selling activity for consumer goods includes obtaining periodic orders, ensuring timely supplies, helping dealers with desired style of display and building up a personal network of dealer relationships over time. If you decide to use personal selling as part of your promotional activity, you could often find that while it is costly in terms of time & effort, it helps to get valuable feedback and market information about your customers and competitors. You are also able to monitor the movement of your goods and assess the relative performance of the various products in your product line.

In order to perform the PERSONAL selling function well, you need to

- know your own product extremely well, specially in terms of how it is better or different from the competitor's product;
- know your competing products well;
- know the trade practices regarding margins to be paid and credit to be allowed to the distributors and retailers;
- listen carefully to what your customers need;
- collect information about what is the consumption pattern shown by your distributors;
- address your customers with due courtesy and regard;

- highlight the advantages of your product compared with your competitor's products;
- be persuasive and make persistent efforts to get the orders; and
- always highlight your unique selling proposition, if any.

14.12 ROLE OF SALES PROMOTION

As explained in the initial part of this unit, sales promotion refers to all promotional activities which are designed to stimulate the features of a product by offering some kind of incentives. The incentives may be directed at the target customers or the dealers. Sales promotion is usually of a short duration and the schemes announced have a fixed time within which they will be operational. By using sales promotion, you not only provide the customer a reason to buy, but also a reason to buy now or buy a far larger quantity than he or she would otherwise have bought. You may, as the producer of value added food products, need to some times offer incentives to move your products fast into the market. Let us identify some of the sales promotion methods that can be used by you. The sales promotion methods directed at the consumers include the following:

- *Price off schemes:* These offer a price discount for a specific period. You may use the scheme as an inaugural discount or as a discount on large purchases.
- *Samples:* Samples involve free distribution or subsidized distribution of small quantities of your products to your potential customers to let them have an idea of what the product is like. Samples enable customers to taste the product and check the quality by themselves.
- *Pack in premium:* Such schemes involve the offer of a free article along with the product for example, a free teaspoon or a bowl along with a jar of fruit preserve.
- *Quantity off:* These schemes offer extra quantity at no extra cost.
- *Coupons:* Coupons entitle the buyer to a stated saving on the purchase or the future purchase of the product.
- *Cash refund offers:* These offers are also like coupons except that in this case the refund in cash form is made after the purchase
- *Contests and games:* Such schemes invite the customers to participate in a contest or a game and some are given prizes through a lucky draw or some other objective method. Such contests get very popular among children and are an excellent device to popularize a new product or gain wide awareness among consumers.

Sales promotion schemes may also be directed at your dealers or sales persons. Buying allowances, free goods, display material, and sales contests are some of the common trade promotions used by small businessmen and entrepreneurs.

Activity 6

Make a quick survey of recent newspaper advertisements or TV advertisements to identify some of the sales promotion schemes that are used for food products. In your view, what are that types of schemes that are most common in the case of such products? What do you think is the impact of such schemes on potential customers?

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14.13 EVALUATING THE EFFECTIVENESS OF YOUR PROMOTIONAL EFFORT

As a manufacturer of value added products, who has put in effort and resources towards promoting his products, you may like to find out whether your promotional effort has been effective or not. One of the most common indicators that people try to use is the increase in sales, but you would agree that there is always a time lag between advertising effort and sales results. Let us understand how can you evaluate whether your promotion has been effective?

While discussing the objectives of promotion in the beginning of this unit, it was pointed out that promotion could have two types of objectives, the communication objectives and the sales related objectives. Under the same section the DAGMAR approach to promotion objectives was also explained. Your task of measuring the effectiveness of your promotion would be strongly dependent upon the precise objectives that you defined for the promotional activity. You can therefore, measure the effectiveness of promotion by

- Measuring the communication effectiveness of promotion.
- Measuring the sales effect of promotion.
- Measuring the relative impact of different media used by you.

The communication effectiveness of promotion is measured by testing the awareness levels of your target customers about your product before and after the promotion campaign, or recall and recognition levels of your brand, based on the objectives defined by you.

Sales are a result of both promotion as well as other elements of your marketing effort. It is therefore, usually difficult to isolate the effect of only the promotional inputs. The fact that there is a time lag between the effort made and the resulting sales, makes the situation even more complicated. The sales effect of advertising is measured by the regression analysis over time. However, sales effect of specific schemes used is easier to calculate. For

example, if you have used direct mail as your promotion method, the sales orders received as a response would let you judge the effectiveness of your promotion in terms of sales effect. Again, if you have used coupons as a sales promotion method, the number of coupons received by you becomes a direct measure of the sales resulting on account of the coupons

Manufactures also use different levels of promotional effort or different kinds of appeals in different market territories to compare and measure the sales effect of these efforts.



14.14 LET US SUM UP

In this unit, an effort has been made to introduce to you the basic components of the promotion mix that can be used by you to promote the sales of your product in the market and establish your market identity among your customers. The role of each of these components has been discussed. The important decisions in your promotional activity, right from deciding upon the promotion mix and setting up the promotion budgets to evaluating the effectiveness of your promotion have been discussed at length. The unit also tries to give you an idea of the different media that can be used for low units value items like food products.

14.15 SELF ASSESSMENT QUESTIONS

1. What is the significance of promotion in the effective marketing of value added food products? Explain with the help of suitable examples.
2. How do advertising and promotion work? What is the kind of effect that these may have on consumers of your products?
3. What do you understand by the term promotion mix? What are the components of the promotion mix?
4. What are the factors that help you decide upon the design of your promotion mix? Assume that you are a manufacturer of several types of sauces and spice blends. While spice blends from other manufacturers are also available, your sauces are unique and innovative. They are targeted at the high end market. Explain the factors you would consider while selecting your promotion mix. Also specify what type of components would you use in your promotion and why?
5. How would you decide your promotion Objectives? Discuss with reference to the product you want to promote in the market place.
6. What are the media options available to producers of value added food products who want to promote their products?
 - a) On our nation-wide basis?
 - b) In the local markets?
 - c) In the export market?

Explain with reference to specific product examples chosen by you.

7. How can the effectiveness of promotion be evaluated? Explain with the help of suitable examples.

UNIT 15 PERFORMANCE MEASUREMENT AND CONTROL

Structure

- 15.0 Objectives
- 15.1 Introduction
- 15.2 Meaning and Features of Controlling
- 15.3 Procedure of Controlling
- 15.4 Tools and Techniques of Controlling
- 15.5 Let Us Sum Up
- 15.6 Key Words
- 15.7 Answers to Check Your Progress Exercise
- 15.8 Some Useful Books
- 15.9 Assignments

15.0 OBJECTIVES

After studying this unit, you should be able to:

- understand the relationship between planning and controlling;
- comprehend the meaning and need for measuring performance;
- get a clear view of the performance measures;
- understand the concept of controlling and its procedure;
- know about the procedure of controlling; and
- have an insight into the important tools and techniques of controlling.

15.1 INTRODUCTION

A businessman has always to look ahead in terms of production, sales, expenses, profitability, customers, etc. In the process of looking forward and assessing his future he should be mindful of various activities happening in his firm. He should occasionally, stop and review his previous activities to see whether his business is running on the right track as he desired or not. Planning is important but review of measurement of performance and its control is also equally important. Both of them are in fact complementary and supplementary to one another. Controlling is effective only when there is proper planning, and planning is fruitful only when there is effective control. The inter-dependency of planning and control can be shown through the following diagram.

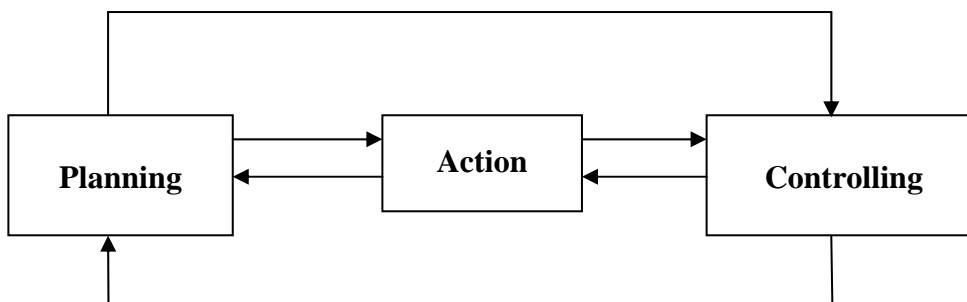


Figure 15.1: Diagram showing inter-dependency of planning and control

Performance Measurement

In this Unit you will learn the importance of performance measurement and control.

Meaning

Performance measurement is a management function. It helps in detecting, preventing or eliminating distortions in the process or product. The aim is to match the product to the customer's requirements. Performance measurement makes the organization capable of taking sound decisions about the action to be taken to ensure appropriate processes and products.

Need for Measuring Performance

If an activity cannot be measured, its effect cannot be seen and suitable correctives cannot be applied. The activity cannot then be controlled and managed.

What are performance measures

A performance measure is composed of a 'number' and a 'unit of measure'. The number gives us a magnitude (how much) and the unit gives the number a meaning (what). Performance measures are always tied to a goal (the target). These can be represented by hours, meters, number of reports, units of product manufactured etc. They can show the variation from the standards set.

Two types of unit of measures are used:

- i) single-dimensional unit of measure;
- ii) multi-dimensional units of measure.

In case of single dimensional units, performance measures can be represented by units like hours, meters, rupees, number of reports, etc. They can show the variation in a process. Single-dimensional units of measure usually represent basic measures of some process or product.

In case of multidimensional units of measure, performance measures are expressed as ratios of two or more basic units. These may be units like number of bottles of jam produced per month, number of hours worked to produce a packet of papads, etc. Performance measures expressed this way convey more information than the single-dimensional or single-unit performance measures.

Foundation for a Performance Measurement System

Successful performance measurement systems are based on the following principles:

1. A businessman should focus on customer needs and based on that measure what is needed to be measured.
2. A businessman should measure only that which is important and will affect customers' satisfaction.
3. A businessman should involve employees/workers in the design and implementation of the measurement system. He should give them a sense of purposeful control, which will lead to improvement in the quality of the measurement system.

Benefits of Performance Measurement

1. *To ensure that the decisions are based on facts*

The businessman can ensure that his decisions are based upon well-documented facts and figures and not on intuition and gut feelings.

2. *To show the areas of improvements*

Performance measurement can show the areas where improvements need to be made. The businessman can come to know where he can do better or how he can improve.

3. *To reveal the clear picture of improvements*

Based on measurement of performance the businessman can have a clear picture whether the improvements have actually occurred or not.

4. *To reveal incorrect assumptions*

If the businessman has been doing his business for a long time, he might have been assuming incorrectly that things are going well, whereas in actuality that may not be the case. Thus, without measurements there is no way to tell whether the business cannot do better.

Performance Measures

Performance measures are generally expressed in terms of quantity. They provide useful information to the businessman so that he may make intelligent decisions about his business. They tell him something important quantitatively about the processes with the help of which products are manufactured. In a nutshell, performance measures tell him:

- how well he is doing;
- if he is meeting his goals;
- if his customers are satisfied;
- if his processes are well in control;
- if and where improvements are necessary.

Features of an ideal unit of measure

Following are the features of an ideal unit of measure:

1. It should be understandable.
2. It should reflect the needs of the business.
3. It should reflect the customer's needs.
4. It should be capable of wide application.
5. It should be interpreted uniformly.
6. It should be precise in interpreting the results.
7. It should be economical to apply i.e. its should be cost effective.



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Fill in the blanks:

- a) Performance measure can be used for exercising _____.
- b) A performance measure is composed of a number and a _____.
- c) 'Hours' is an example of _____ dimensional unit of measurement.
- d) Performance measures are generally expressed in _____.
- e) A performance measure should reflect the needs of the _____ and the business.

2. State True or False:

- a) A businessman should measure only important activities of the firm.
- b) A businessman should involve the employees in the formulation of measurement system.
- c) An ideal unit of measurement should be expensive to apply.
- d) Single-dimensional unit of measure conveys more information than multi-dimensional unit of measure.
- e) Measurement of performance does not provide a clear picture whether the improvement has actually taken place or not.

3. Name any two performance measures.

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15.2 MEANING AND FEATURES OF CONTROLLING

Let's go down the memory lane. Think of those days when you were in Class XII studying for your first terminal examination. You decided to secure 75% marks in aggregate and started studying accordingly. When you received your Report Card you were shocked because you could manage to get only 60% instead. After certain hue and cry you must have sat down and thought that where you went wrong –

- Whether your scheduling was incorrect; or
- Whether your syllabus was too heavy; or
- Whether you got nervous right at time of examination; or
- Whether you had not revised the lessons thoroughly.

Lastly, you must have made fresh plans to do better at the next terminal examination by making a proper timetable, by revising the lessons thoroughly and by streamlining your study pattern.

In the above process you have unknowingly applied the controlling procedure.

Controlling Defined

Controlling is nothing else but to set standards, measure the performance, compare the performance with the standards set and take corrective measures if deviations are found. In other words controlling is comparing operating results with the plans and taking corrective action when result deviates from the plan. Thus, controlling is an ‘action oriented’ process.

Control process can be illustrated with the help of an example of automatic iron, which is fitted with thermostat. As soon as the iron is switched on the bulb lights up – it means that the current is passing in the iron. The current goes on passing as long as the temperature does not reach the level at which the thermostat is set. Immediately after the temperature reaches that level, the thermostat starts functioning and the current is disconnected, thereby causing the bulb to go off. When the temperature becomes low than the level set, the thermostat allows again the current to pass and the bulb lights up. Here, the thermostat is acting like a controlling device, which compares the actual performance with the standard set. It starts functioning and disconnects the electric current when the actual deviates from the standard.

Features of Controlling

- It is the last function of management process, the first function being planning.
- It is a dynamic process, adapting itself to the changes in the environment.
- It is a continuing process.
- It is pervasive in nature i.e. it is found at all the levels of management.
- It is backward looking because it involves feedback and responses. It is linked with – what has happened in the past.

Check Your Progress Exercise 2



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Why is controlling referred to as ‘backward looking’.

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2. Mention two features of controlling.

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3. If controlling is said to be the last function of management process then which one is the first function?

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15.3 PROCEDURE OF CONTROLLING

Let's now discuss the control process. It embraces the following steps:

i) Fixing standards

Standards serve as a test of performance. It is a criterion against which results are measured. Standards can be expressed in physical terms and monetary terms. If we say that the firm is required to manufacture 1000 packets of tomato puree in a week, this is expressing standards in physical terms. In case the standard set is to increase the sales by Rs. 10,00,000 by the end of the current financial year, this is expressing standards in monetary terms.

The standards should be easily understandable, result-oriented and attainable. They should be scientifically set with the help of time and motion studies. Workers should also be consulted in order to involve them in achieving the standards set.

In general, good performance standards should have the following attributes:

- *Understandable:* Standards should be expressed in simple and clear terms, so as to avoid misinterpretation or vagueness. Similarly, instructions for their use should be specific and complete.
- *Attainable:* Standards should be such that they can be attained with reasonable efforts under the given conditions.
- *Economical:* Cost of setting and administering the standards should be low in relation to the activity covered and the benefit to be derived.
- *Applicable:* Standards should be such that they can fit the conditions under which they are to be used. If conditions vary, they should contain built-in flexibility to meet these variables.
- *Consistent:* Standards should help to unify communication and operations throughout all functions of the company.
- *Stable:* Standards should have a fairly long life to provide comparability.
- *Adaptable:* Standards should be designed in such a way that elements can be added, changed, and brought up-to-date without much complexity.

- *Equitable:* Standards should be accepted as a fair basis for comparison by the people who have been assigned the responsibility of meeting the goals.
- *Customer-focus:* Standards should address areas, which are important to the customer (internal/external) such as cycle time, quality, cost schedule performance, and customer satisfaction.

ii) Measurement of performance

Performance can be measured through inspection, observation, measurement and reporting. Uniform reports should be prepared at regular intervals. Performance measurement should be an ongoing process. It is easier to measure the standards if they are tangible in nature. For example, Rahul & Co. sets the standard to reduce the advertisement expenses by Rs. 50,000 in the next six months. This standard being tangible can be easily measured with the actual performance by looking at the figures of actual advertisement expenses. But, in cases where standards are not tangible like result expected from a training programme for salesmen, measurement of results becomes complicated.

iii) Comparison with actual performance

The actual performance should be measured with the standard set. If deviations are found exceptionally wide then only should be concentrated upon. It helps in conserving time and effort of the businessman. For long-run standards (like increase in return on investment) annual comparison may not at all be appropriate. But in case of short-run standards (like to maintain a minimum cash balance of Rs. 1000) comparison can be on daily basis. For certain short-run standards comparison can be on weekly or monthly basis e.g. to reduce the selling and distribution expenses by 2% within a period of 4 months.

iv) Finding the cause of deviation

A very wide range of deviation is analysed at this stage. It is done so to find out the various reasons of its occurring. This analysis should be promptly done to make control effective.

v) Taking corrective actions

Remedial action is to be taken so that deviations may not occur again and objectives are properly achieved. Corrective action may involve:

- *Let the situation remain as it is:* This is applicable if the deviation is insignificant i.e. within tolerable limits (which should be set in advance).
- *Correct the deviation:* This can be done by improving the performance e.g. defective tools to be repaired, generators to be installed, close supervision, incentives to be provided, appointing more salesmen, good training provided etc.
- *Revision of standards:* The standards may need to be revised if they are not effective for required control.

Check Your Progress Exercise 3

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Write any two examples of standards which can be easily measured and compared.

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2. What will be the consequence if the standards fixed are on higher side?

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3. Why the reporting should be quick?

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15.4 TOOLS AND TECHNIQUES OF CONTROLLING

1. Ratio Analysis

Ratio analysis is a study of relationship among various financial factors in a business like sales, gross profit, net profit, stock, debtors, fixed assets etc. It is a technique of analysing the financial statements by computation of ratios. Ratio analysis acts as an important and effective control device in an organization. It is the process of establishing a significant relationship between the items of financial statements to provide a meaningful understanding of the performance and financial position of a firm. Ratio analysis focuses attention on relative figures which should be significantly related. For example, figure of sales when related to the figure of gross profit will indicate gross margin earned on sales. This means both the figures in the ratio are significantly related. Ratio analysis seeks to measure the effectiveness and profitability of the various functions.

Controlling process starts when the accounting ratios are compared with their own past ratios or with the ratios of similar firms in the same industry. For example, a Fruit Jelly manufacturer measures that his gross profit ratio for current year is 18% whereas in the immediate past year it was 22%. Thus, on comparing the gross profit ratio he finds the deviation. Now he has to take remedial action to improve the ratio.

Some of the important ratios used in controlling the affairs of a business are:

- i) Return on Investments (ROI)
- ii) Net profit to Sales (Net Profit Ratio)
- iii) Sales to Capital employed (Capital Turnover Ratio)
- iv) Gross profit to Sales (Gross Profit Ratio)
- v) Sales to Working Capital Ratio (Working Capital Turnover Ratio)
- vi) Stock Turnover Ratio
- vii) Operating Ratio
- viii) Current Ratio
- ix) Debtors' Turnover Ratio

Let's now discuss these ratios.

i) Return on Investments (ROI)

This ratio shows the relationship between net profit (before interest and tax) and capital employed. It indicates how efficiently the capital employed in the business has been used. In other words it shows the firm's ability to generate profit per rupee of capital employed. It is a measure of overall profitability of an enterprise. Higher the ratio the better it is.

$$\text{Formula: Return on Investments (ROI)} = \frac{\text{Net profit (before interest and tax)}}{\text{Capital employed}} \times 100$$

where Capital employed = Fixed assets + Working capital

For example, a company manufacturing various bakery items has earned a net profit (before interest and tax) of Rs. 4,00,000 during the current financial year. The company has Rs. 16,00,000 as capital employed. The ROI works out to 25%. In the same industry ROI is 20%. This means the company has used its capital efficiently.

ii) Net Profit to Sales (Net profit ratio)

This ratio shows the relationship between net profit and net sales. It measures the rate of net profit on net sales. It helps in ascertaining the efficiency with which the affairs of the firm are being managed particularly its marketing. In case the ratio increases, it indicates improvement whereas if it declines, it reveals inefficiency in the management of the affairs of the firm.

$$\text{Formula: Net Profit Ratio} = \text{Net Profit/Net Sales} * 100 = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

For example, the net profit of a firm is Rs. 1,00,000 and the net sales is Rs. 4,00,000. In this case, the Net Profit Ratio is 25% as calculated below:

$$\text{Net Profit Ratio} = 1,00,000 / 4,00,000 * 100 = 25\% = \frac{1,00,000}{4,00,000} \times 100 = 25\%$$

In the corresponding next year, if the Net Profit Ratio works out to 30% it will show efficiency in the management of the affairs of the firm.

iii) Sales to Capital Employed (Capital Turnover Ratio)

This ratio shows the relationship between net sales and capital employed. It indicates the firm's ability to generate sales per rupee of capital employed. Higher the ratio the better it is.

$$\text{Formula: Capital Turnover Ratio} = \frac{\text{Net sales}}{\text{Capital employed}}$$

where Capital employed = Fixed assets + Working capital

For example, net sales of a company is Rs. 8,00,000. The company has Rs. 2,00,000 as capital employed. The Sales to Capital employed (Capital Turnover Ratio) works out to 4 times. i.e.

$$\frac{8,00,000}{2,00,000} = 4$$

iv) Gross Profit to Sales (Gross Profit Ratio)

This ratio shows the relationship between gross profit and net sales. It indicates the gross margin earned on sales.

$$\text{Formula: Gross Profit Ratio (GP Ratio)} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

For example, a spices manufacturing unit earns a gross profit of Rs. 5,00,000 during the current financial year. Its net sales (i.e. gross sales – sales returns) are Rs. 25,00,000. In this case the GP ratio works out to 20%. Higher the ratio the better it is.

v) Sales to Working Capital Ratio (Working Capital Turnover Ratio)

This ratio shows the relationship between net sales and the working capital. It indicates the efficiency with which the firm has utilised its working capital. In other words it signifies the ability of the firm to generate sales per rupee of working capital. Higher the ratio the better it is.

$$\text{Formula: Working Capital Turnover Ratio} = \frac{\text{Net sales}}{\text{Working capital}} \times 100$$

where Working capital = Current assets – Current liabilities

For example, a grocery dealer's sales during the current financial year are Rs. 18,00,000. His working capital is Rs. 6,00,000. In this case Sales to Working Capital Ratio (Working Capital Turnover Ratio) works out to 3 times.

vi) Stock Turnover Ratio

This ratio shows the relationship between cost of goods sold and the average stock. It indicates the efficiency with which the firm has utilised its stock. In other words it signifies the speed with which stock is converted into sales. Higher the ratio the better it is.

$$\text{Formula: Stock Turnover Ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

where (i) Cost of goods sold = Opening Stock + Purchases + Direct Expenses – Closing Stock and (ii) Average Stock = (Opening Stock + Closing Stock) / 2.

For example a mango juice manufacturer's cost of goods sold during the current financial year amounted to Rs. 10,00,000. His average stock during this period was Rs. 2,00,000. In this case Stock Turnover Ratio works out to 5 times.

vii) *Operating Ratio*

This ratio measures the relationship between operating cost and net sales. It indicates the operational efficiency with which the production or purchases or selling operations are carried on. Lower the ratio the better it is.

$$\text{Formula: Operating ratio} = \frac{\text{Operating cost}}{\text{Net sales}} \times 100$$

where (i) Operating Cost = Cost of goods sold + other operating expenses like administrative expenses, selling and distribution expenses etc.

For example a tomato puree manufacturer's cost of goods sold during the current financial year amounted to Rs 10,00,000 and other operating expenses were Rs. 75,000. His sales during this period were Rs. 25,00,000 whereas sales returns were Rs. 50,000. In this case the operating ratio works out to 43.88% as calculated below:

$$\text{Operating Ratio} = 10,75,000/24,50,000 \times 100 = 43.88\%.$$

viii) *Current Ratio*

This ratio measures the relationship between current assets and current liabilities. It indicates the ability of the firm to meet its short term obligations. In other words it shows short term financial solvency of the firm. Ideal current ratio is 2:1.

$$\text{Formula: Current Ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

where (i) Current assets = Cash and bank balance, marketable securities, debtors, bills receivables, stock, prepaid expenses etc. and (ii) Current liabilities = creditors, bills payable, bank overdraft, short term loans etc.

For example a ginger and garlic paste manufacturer's current assets as on 31st March 2004 were Rs. 6,00,000 and current liabilities were Rs. 3,00,000. In this case the current ratio works out to 2:1.

ix) *Debtors' Turnover Ratio*

This ratio measures the relationship between net credit sales and average debtors. It indicates the ability of the firm to collect its trade debtors. In other words it shows the speed with which the debtors are

collected. A high ratio indicates shorter collection period i.e. debtors are repaying promptly.

$$\text{Formula: Debtors' Turnover Ratio} = \frac{\text{Net credit sales}}{\text{Average debtors}}$$

Where Average Debtors = Opening Debtors (including opening bills receivable) + Closing Debtors (including closing bills receivable) / 2.

For example a 'sarson' oil manufacturer's net credit sales for the year 2004 were Rs. 90,00,000 and average debtors were Rs. 15,00,000. In this case the Debtors' Turnover Ratio works out to 6 times.

2. Cost Analysis and Control

This analysis is associated with various costs of the firm. Cost control is important because all the businessmen – whether operating on a small scale or large scale – always try to contain their all types of costs. For a successful analysis, the businessman should himself have a very clear idea of all the costs. He should also have an effective system to measure and analyse them systematically. Various costs may include – cost of production; cost of credit sales; selling and distribution costs; inventory costs; channel costs; marketing research costs; advertising costs; sales promotion costs etc.

These costs should be measured against the results produced by incurring them. The results may take the form of sales revenue generated, gross profit achieved etc. The efficiency of each product, channel, customer-class, and salesmen should be analysed by measuring their respective contribution to profit of the firm on the one hand and to the overheads on the other.

Cost analysis should also include standard costing for various management functions. It is not enough that costs should be compared with the budgeted costs only. The firm should develop standard costs for each function of market and measure actual cost with the standards set.

Cost analysis helps the businessman in the following ways:

- It helps to control and reduce all types of costs.
- Cost reduction leads to savings.
- It leads to alternate ways of performing functions to reduce the costs.
- Prices can be kept at competitive rates if costs are reduced.
- The businessman can drop unprofitable customers, products, dealers etc. from the list.

3. Credit Control System

A businessman generally prefers to sell his goods on cash basis. It is because of the following reasons:

- No risk of bad debts.
- Less working capital required because of continuous cash generation.
- Short operating cycle.

Despite above advantages of selling goods on cash basis, the businessman may still be forced to sell goods on credit basis on instalment basis to achieve higher turnover. There may be number of problems attached to the selling of goods on credit or instalment basis like:

- Interest on money involved.
- Money blocked for longer period of time.
- Legal hassles i.e. court cases if money is not realized.
- Loss due to insolvency of debtors.
- More accounting work involved.

Despite these problems a businessman sells his goods on credit or instalment basis because he has to survive in the market, and higher turnover may offset losses and such sales.

In case he sells his goods on credit basis, he should frame a clear credit policy. The businessman should also have a proper credit control system on the following lines:

- i) Credit should be extended to the customers and dealers after a proper credit rating is made. A credit rating analysis would reveal the soundness of the customers and dealers. No-risk customers may be extended large credit limits. High-risk customers could be given credit only if bank guarantee or collateral security is made available.
- ii) The businessman should also adhere to the prescribed credit limits.
- iii) As a part of credit control system he should analyse the accounts receivables and bad debts. The number, type, extent and integrity of the debtors or the reason for a debt to become bad must be brought out by the analysis. The age of debtors outstanding should be determined (i.e. 15 days old debts, 30 days old debts, 45 days old debts, 180 days old debts, 365 days old debts etc.) from time to time and based on this analysis corrective action should be taken.
- iv) A proper credit control system will ensure that the cost of credit is built to the price itself.
- v) Strategies like offering cash rebates in lieu of credit can be thought of. Cash discounts may be offered for quick recoveries.

4. Budgetary Control

A budget is a plan for some specific future period. It is based on objective to be attained. It is expressed in monetary or physical units. A budgetary control is a system in which all operations are forecast and planned and the actual results are compared with the forecast and the planned ones for reviewing policy are programme for the balance period or for next period.

Budgetary control can be applied to every function of the business i.e. production, finance, human resources, marketing etc. It corrects the deviations from pre-planned path through observation, research, reporting, planning and decision making. The future activities of the business can thus, be performed in an orderly way.

The procedure of budgetary control involves the following steps:

- i) Establishing the budgets.
- ii) Continuous comparison of actuals with budgets by preparing control statements which will show:
 - Budgeted figures
 - Achieved figures
 - Variances
- iii) Placing the responsibility for failure to achieve the budgeted figures.
- iv) Revision of budgets.

Advantages of budgetary control.

Following are the advantages of budgetary control:

- i) It helps in bringing efficiency and economy in the working of the business enterprise.
- ii) It fixes responsibility on every division or department of the enterprise.
- iii) It coordinates the various divisions of a business i.e. production, marketing etc.
- iv) It serves as an automatic check on the decisions of the management.
- v) Credit agencies favour that organisation which operates through a well-ordered budget plan.

5. Break-even Analysis

Break-even analysis is yet another controlling device which can be used by a businessman. It is an important tool of profit planning. It is also called cost-volume-profit (CVP) analysis. It facilitates cost control by measuring operational efficiency. At break-even point the businessman neither makes profit nor incurs losses. For calculating break-even point we need to understand the following concepts:

- i) *Fixed costs (FC)*: Fixed costs are those costs which remain constant whether there is increase or decrease in production over a given period of time. These costs are fixed in nature and are incurred as soon as the business is started. This concept of fixed costs remains valid up to a particular level of operation.

Examples of fixed costs are – rent of the premises, salaries of the employees, depreciation, interest charges on long term debts, insurance premium, property tax etc. Even if there is no production, these fixed costs will be incurred. Suppose, a jam manufacturer incurs Rs. 40,000 towards fixed costs for manufacturing jam bottles. In this case fixed costs are Rs. 40,000 which shall be considered for calculating break-even point.

- ii) *Variable costs (VC)*: Variable costs are those costs which vary according to the level of production attained. They will increase if the production is increased even by one unit or decrease when there is decrease in production.

Such costs are – raw material costs, wages to the workers, water charges, oil and fuel etc.

For calculating break-even point, generally we consider variable cost per unit of production. Suppose variable cost incurred for manufacturing 1000 jam bottles is Rs. 55,000. In this case per unit variable cost works out to Rs. 55.

Note: For the purpose of calculating total cost of production we have to add fixed cost and variable cost. Thus,

$$\text{Total Cost} = \text{Fixed cost (FC)} + \text{Variable cost (VC)}$$

iii) *Selling price:* Selling price is that price at which the goods are sold. Usually, we consider selling price per unit for calculating break-even point. For example, a jam bottle is priced at Rs. 75. It means that it will be sold to the consumers at this price. Thus Rs. 75 is the selling price per unit of the product.

iv) *Contribution margin:* Contribution margin is the difference between selling price per unit and the variable cost per unit. In other words:

$$\text{Contribution Margin} = \text{Selling Price per unit} - \text{Variable cost per unit}$$

Considering the figures given above contribution margin is Rs. 20 (i.e. Rs. 75 - Rs.55)

It may be noted that for calculating contribution margin, fixed cost is not considered.

After understanding the above concepts, we can move on to calculate break-even point (BEP) with the help of following formula:

$$\text{BEP (in units)} = \frac{\text{Fixed costs}}{\text{Contribution margin per unit}}$$

$$\text{BEP (in units)} = 40,000/20 = 2,000 \text{ units}$$

$$\text{BEP (in value)} = 2,000 \text{ units} * \text{Selling price per unit i.e. Rs.75} = \text{Rs. 1,50,000.}$$

At the level of 2,000 units the manufacturer does not incur any loss nor earn any profit. This is verified as below:

$$\text{Selling price of 2,000 units} = 2,000 * \text{Rs.75} = \text{Rs. 1,50,000}$$

$$\text{Variable cost of 2,000 units} = 2,000 * \text{Rs.55} = \text{Rs. 1,10,000}$$

$$\text{Fixed cost} = \text{Rs. 40,000}$$

$$\text{Total cost} = (\text{VC} + \text{FC}) = \text{Rs. 1,10,000} + \text{Rs. 40,000} = \text{Rs. 1,50,000.}$$

The manufacturer does not earn or lose anything by selling 2,000 jam bottles because at this level both sales revenue (i.e. Rs. 1,50,000) and total cost (i.e. Rs. 1,50,000) are the same. Beyond this level he will start earning profit and below this level he will incur losses.

From controlling point of view the manufacturer has to understand whether he can operate above the level of break-even point. If he can

do so in a shorter span, it is better for him. He must understand that the lower BEP denotes lesser risk.

6. Internal Audit

Internal audit is another effective tool of managerial control. It involves appraisal of operations i.e. weighing actual results in the light of planned results. It is a regular appraisal which is done by trained staff of internal auditors of the accounting, financial and other operations of a business.

It is concerned with long term business interest. It aims at evaluating the entire system of an organisation. It can be said to be a continuous, systematic and bias free study of total efficiency of the firm. It tries to measure and evaluate the effectiveness of all other control devices employed by the firm.

Internal audit is advantageous for the departmental managers as well. They get proper advice from the internal auditors on policies and plans of the firm. The auditors also suggest solutions to managerial problems.

The limiting factors for internal audit are two-fold – first, the business firm should be able to afford an internal audit and secondly, specialized persons should be available who can do a broad type of internal audit.

For making the internal audit successful, full support of subordinates is also required.



Check Your Progress Exercise 4

- Note:** a) Use the space below for your answer.
- b) Compare your answers with those given at the end of the unit.

1. Does ratio analysis technique have an edge over Budgetary Control methods of appraising the performance of an enterprise? If so in what respects?

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2. Below is the performance measurement of Firm A and Firm B in terms of Gross Profit and Sales. You are required to make a comparison and state which of the firms has performed better.

| | Firm A | Firm B |
|---------------------------|---------------|---------------|
| Gross profit (Rs.) | 50,000 | 1,28,000 |
| Sales (Rs.) | 5,00,000 | 6,00,000 |

.....
.....
.....

3. Based on the following figures you are required to ascertain whether the performance of Firm A is improving or not:

| | Year I | Year II |
|-----------------|---------------|----------------|
| NP ratio | 12.21% | 10.32% |

.....

4. Which technique aims at a total evaluation of the entire system of an organisation?

.....

5. Give one word for the following.

a) Certain costs which remain constant over a period of time.

a)

b) Costs which vary according to the level of production.

b)

c) A specialized person who evaluates various controlling techniques adopted by a firm.

c)

d) A monetary or physical plan meant for a specific future period.

d)

e) An effective controlling tool which establishes relationship between items of financial statement.

a)

15.5 LET US SUM UP



Measurement of performance and its control is quite important because substantial benefits are realized by organizations which implement performance measurement programmes. Being a function of management, performance measurement makes the organization capable of taking sound decisions. Performance measures are generally expressed in terms of quantity. A performance measure is composed of a 'number' and a 'unit of measurement'. Single-dimensional and multi-dimensional are two types of units of which are generally used. An ideal unit of measurement should reflect needs of the customer and business; should be understandable, capable of being applied over a wide area and interpreted uniformly. Performance

measurement is associated with controlling. Controlling is nothing else but to set standards, measure the performance, compare the performance with the standards set and take corrective measures if deviations are found. Some of the important tools and techniques of control are ratio analysis, cost analysis and control, credit control system, budgetary control, break-even analysis and internal audit.

15.6 KEY WORDS

| | | |
|----------------------------|---|---|
| Quality | : | The degree to which a product or service meets customer's requirements and expectations. |
| Control | : | The set of activities employed to detect and correct variation in order to restore a desired state of conformance with quality goals. |
| Remedial action | : | Measures taken to rectify conditions adverse to quality. |
| Unit of measurement | : | A quality feature that permits evaluation of that feature in numbers. |



15.7 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

- control
 - unit of measure
 - single
 - quantity
 - customer
- False
 - True
 - False
 - False
 - False
- Hours
 - Metres

Check Your Progress Exercise 2

- It is based on feedback.
- It is the last function of management.
 - It is a continuing process.
- To plan the objectives of the firm.

Check Your Progress Exercise 3

- Hint:**
 - Reduction in advertisement expenses by Rs. 50,000 in next 6 months.
 - Increasing the production by 5,000 units in next one month.

2. Standards will not be met leading to wastage of time, money and efforts as well as de-motivation for the concerned person.
3. To take remedial action quickly.

Check Your Progress Exercise 4

1. **Hint:** Ratio analysis focuses attention on relative figures which are actual. These figures are significantly related. Ratios help in judging solvency, profitability and liquidity of an organization. However, in case of Budgetary Control methods the budgets are prepared bases on estimated figures (future estimates) which are not actuals. Based on budgets solvency, profitability and liquidity of an organization can not be judged.
2. Firm B's performance is better because its GP ratio is high.
3. Firm A has not improved.
4. Internal audit
5.
 - a) Fixed costs
 - b) Variable costs
 - c) Internal auditor
 - d) Budget
 - e) Ratio analysis

15.8 SOME USEFUL BOOKS

1. Bhushan, Y.K. (2001) Fundamentals of Business Organisation and Management, Ed., Sultan Chand and Sons, New Delhi.
2. Chandra, Prasanna — Projects-Planning, Analysis, Selection, Implementation & Review, 1996 Reprint, Tata McGraw Hill Publishing Company Limited, New Delhi.
3. Gupta, R.L. & Gupta, V.K. (2001) Principles & Practice of Accountancy, Ed., Sultan Chand & Sons, New Delhi.
4. Koontz, Harold and Cyril O'Donnell — Principles of Management: An analysis of Managerial Functions – McGraw-Hill Inc.
5. Maheshwari, S.N. and Mittal, S.N. (2001-02) Cost Accounting, Theory and Problems, Ed., Shree Mahavir Book Depot (Publishers), Delhi.
6. Ramaswamy, V.S. and Namakumari, S. (1998) Marketing Management (Planning, Implementation and Control-The Indian Context), Reprint, Macmillan India Limited, Delhi.
7. Varshney, R.L. and Gupta, S.L. (2000) Marketing Management (An Indian Perspective), Ed., Sultan Chand and Sons, New Delhi.

15.9 ASSIGNMENTS

1. Why should a businessman measure his performance?
2. 'Planning and controlling are inter-dependent.' Justify.

Assessing Performance

3. What is control?
4. Explain the procedure of control.
5. Name the accounting ratios which can be calculated using the following financial factors as the basis:
 - i) Turnover and average debtors
 - ii) Turnover and net profit
6. Explain briefly any four benefits of measuring performance.
7. A businessman wants to apply budgetary control in his firm. He has already established the budgets for the current financial year. What according to you should he do next?
8. Why should a businessman analyse his costs?
9. What are performance measures? Explain its types briefly with examples.
10. Explain the features of controlling.
11. The following data relates to Evergreen Products Ltd.

| Particulars | March 31, 2003 | March 31, 2004 |
|--------------------|----------------|----------------|
| Sales | 20,00,000 | 26,00,000 |
| Cost of Goods Sold | 15,00,000 | 21,20,000 |

The manager claims that he has worked more efficiently during 2004 because the sales and gross profit have increased and should get reward for his efficiency. The management of the company has sought your advice on the Manager's claim. Please advise.

(Hint: Calculate GP ratio)

12. What is internal audit?
13. Write the meaning and the formula of the following:
 - i) Net Profit Ratio
 - ii) Debtors' Turnover Ratio.
14. The following table gives actual and standard ratios for the year 2004-05 in case of Ganga Masale Di Hatti. Examine these ratios and suggest remedial action which the businessman should take.

| Particulars | Actual ratio | Standard ratio |
|--------------------------------------|--------------|----------------|
| Current assets / current liabilities | 6 | 2 |
| Cash/current liabilities | 5 | 1 |
| Debtors/sales | 9 | 12 |

(Hint: 1. The funds are lying idle and they can be invested.
2. Short term planning of funds should be improved by investing idle funds in income-yielding investments.
3. It indicates that the debtors are collected promptly.)

UNIT 16 MANAGING GROWTH

Structure

- 16.0 Objectives
- 16.1 Introduction
- 16.2 Meaning of Growth and Its Measures
- 16.3 Need for Growth
- 16.4 Growth Strategies
- 16.5 Stages of Growth and Challenges Faced by the Entrepreneurs
- 16.6 Let Us Sum Up
- 16.7 Key Words
- 16.8 Answers to Check Your Progress Exercises
- 16.9 Some Useful Books
- 16.10 Assignments

16.0 OBJECTIVES

After studying this unit, you should be able to:

- know about the growth of a business;
- understand the need of growth for a business;
- identify various measures of growth;
- comprehend the type of growth strategies used by business firms;
- understand the various stages of growth; and
- know the challenges faced by a businessman during the various stages of growth.

16.1 INTRODUCTION

What is Growth? What does this term mean? Haven't all of us grown from small children to adults? In fact, we find 'growth' all around us. Does not the small rose bud in our backyard grows and blooms into a beautiful flower? Does not a small mango sapling grow into a big mango tree? Does not a small kitten grow into a lovely cat? So, we find that growth is everywhere around us – whether it is a bud plant, an animal or a human being. In their growth process, human beings pass through the stages of infancy, childhood, adulthood and old age. Thus, in each and every case whether it is the question of survival of human beings or of a business, growth is a must. In the following Unit we will discuss the various aspects of growth of a business firm.

16.2 MEANING OF GROWTH AND ITS MEASURES

Meaning of Growth

The growth of a businessman is quite similar to that of a human being. It is a positive phenomenon. It is gradual. A businessman grows from the very initial stage – the day he starts the business and struggles hard to survive in the market – but slowly and gradually he finds himself in a stable and comfortable position. There are a large number of business firms, cottage industries etc.

which started in a small way and now have been transformed into big organisations, e.g. MDH, Amul Co-operatives, etc.

Measures of Growth

There are various parameters through which a businessman can come to know whether his business is growing or not. Some of the important measures of growth are as follows:

1. An increase in total net worth of the firm i.e. capital + reserves.
2. An increase in the size of total business of the firm.
3. An increase in the total number of employees.
4. An increase in the volume of output.
5. An increase in the monthly or yearly sales of the firm.

For better understanding, let’s read the following Table 16.1:

Table 16.1: Growth in business

| Particulars | First year | Second year |
|---------------|------------|-------------|
| Revenue (Rs.) | 1,00,000 | 5,00,000 |

Looking at the table it is clear that the sales revenue has increased by Rs. 4,00,000 in the second year i.e. the businessman has attained growth in his business.

16.3 NEED FOR GROWTH

A business man is motivated to grow for more than one reason. The various factors which drive him to grow are discussed in the following paragraphs.

1. Forces of competition

A businessman needs to grow if he wants to survive in the market. Acute competition usually forces a businessman to grow in order to maintain his existence. In other words, a businessman has to be creative or he should innovate new things so that he is able to retain his present position.

2. Economies of bulk

A businessman can avail certain benefits if he increases his volume of production. Large scale production provides several economies not only in the field of production but also in the areas of marketing, finance, management etc. Such economies of scale may include strong bargaining power, lower overheads, availability of finance at lower rates etc. The per unit cost of operation gets lowered due to the above mentioned economies.

3. Better returns

The motive of the businessman to obtain more and more profits leads him to grow. He ensures growth of his organisation through continuous ploughing back part of profits instead of distribution of entire earnings .The size of the business thus gets expanded.

4. *Modern technology*

Business firms try to expand the size of the business in order to take advantage of modern or latest technology. Only large firms can take full advantage of hi- tech machines.

5. *Goodwill*

At times business firms prefer to expand in order to command power and respect. People take pride in owning business of large size. Business firms grow to achieve reputation. With reputation and size, power is not far behind. Big companies, no doubt, have more economic and social power compared to small business units.

6. *Personal factors*

Personal factors comprise individual organizational abilities, ambition etc. These factors also drive businessmen towards growth of their business firms. Certain businessmen may be highly ambitious or they may be endowed with special organizational skills. They may want to be independent too in respect of, say, marketing of raw materials or finished products.

7. *Trade cycles*

Trade cycles also influence the decision of growth of a business firm. During a period of boom businessman generally reaps high profits due to high production and high sales. The problem arises when at the time of depression economic activities come to the lowest level. The demand for the products goes down and so do the prices and profits. At this point of time when the businessmen are faced with the problem of closing down the business, they think of joining with other firms. They combine their businesses and grow.

Check Your Progress Exercise 1



Note: a) Use the space below for your answer.

b) Compare your answers with those given at the end of the unit.

1. Mention any two economies of scale which a businessman may avail in the process of expansion.

.....

2. Name two measures of growth.

.....

3. Name the need of growth in the following cases:

i) Mr. Khanna wants to make use of baking machine which has some added features of speed, volume etc.

i)

ii) Mr. Ram Vilas has a desire to own and control a big business house.

ii)

16.4 GROWTH STRATEGIES

A strategy is a well-planned course of action designed to achieve a specific objective. A growth strategy is a strategic plan meant to expand the operations of a business firm. A strategy which a firm may adopt will depend upon the fact whether the businessman wants to develop internally or externally.

Following are the main strategies which are usually followed by the businessmen for the growth of their enterprise.

A) Internal Growth Strategies: Internal growth strategy can be sub-divided into:

1. Expansion; and
2. Diversification

B) External Growth Strategies: External growth strategy can be sub-divided into:

1. Joint ventures; and
2. Mergers.

A) Internal Growth Strategies

Internal growth implies that the business firm expands its business without seeking help from other firms. Involvement of other firms is absent. The business firm grows from within. It is also called aggregative growth strategy.

A case study of Lizzat papad

Seven housewives in a small colony (Shankar Badi Lane, Mumbai) in 1957 sat together and discussed ways to use their spare time in a good and positive manner. They planned to make papads. They had their own doubts and apprehensions. Almost daily they discussed – ‘How would we be able to make papads?’; ‘Who would buy from us?’; ‘Would we have to go to each shop to sell the product, etc.?’ Since their determination and will-power to venture into a new business was very strong, they persevered and began their business with a very modest amount. Today, as we all know they have a vast network. Their turnover, production, profits, employees, machines, net worth etc. all have increased. This is the story of growth of a business from within. Hundreds of other such organisations have also grown in a similar way.

Another case study of Everest masale

Some 40 years ago, Vadi Lal Shah, founder of “Everest Masale” started his career as a shopkeeper in a two hundred sq. ft. shop by manufacturing milk masala. Slowly and gradually his business started growing as he added some basic spices too. In 1968, he launched three blended spices – Everest Garam Masala, Kesri Milk Masala and Tea Masala. Today there are thirty four blends under the Everest brand name. For example, Pav Bhaji Masala, Subzi Masala, Sambhar Masala, Meat Masala, Chat Masala, etc.

The basic spices list also became longer and longer. It now includes turmeric powder, red chilli powder, coriander powder, black pepper powder etc.

At present, his business has grown to such an extent that approximately 1850 million packets of Everest Masale are sold each year. Within a span of forty years the company has captured a 30% market share in Indian food condiments segment. Its blends are available in over three lakhs outlets across a thousand towns and cities. This is another example of internal growth.

A firm may grow internally through:

- i) Expansion
- ii) Diversification

Let's discuss these ways of growth one by one.

i) *Expansion*

A businessman may start looking for opportunities for expansion as his business concern starts moving forward. Expansion is one way of internal growth. A firm may expand by increasing the sales, exploring new markets, developing new products and the like. It may plough back its profits for expansion or it may take loans or advances from financial institutions to increase its production capacity. The business unit will always retain its original character when it expands from within. Expansion may take the following forms:

- a) Market Penetration
- b) Market Development
- c) Product Development

These forms of expansion are discussed below:

a) *Market penetration*

Under market penetration, a businessman tries to increase the sale of his existing products in the existing market. The businessman may try to increase the sales of his existing products in the same market. In other words, there is no change either in the firm's product or in its market. The entrepreneur generally tries to increase the sales by launching sales-promotion techniques e.g. Brook bond offered a glass bowl free with every 250 grams pack of tea to increase the sales of its product. Market penetration can also be achieved by selling goods at reduced prices.

b) *Market development*

Market development is different from market penetration. Under market development the businessman tries to explore new markets for existing products. A businessman dealing in rural areas may try to expand by catering to urban markets. A big manufacturer may on the other hand increase his sales by exploring rural areas as well, e.g. ready-to-eat food packs or fast food item being sold in rural areas. The businessman can also develop his market by crossing the boundaries of the country and start exporting the

goods to the foreign traders or customers in foreign countries. Market development strategy is usually used by a businessman when existing markets are stagnant or when increase in market share is difficult because of powerful competitors.

c) Product development

Product development is yet another strategy adopted by a businessman who has a burning desire to grow and expand his business. Under this method, he plans either to develop a new product or modify the existing product. A product is modified by adding new features or value to it. The point to be noted is that creation of new product or modification of existing product is done for sale in the existing market. Development of new product is usually done to meet the changing needs and wants of the customers, to match new competitive advantage, to get the advantage of new technology etc.

Advantages of expansion

1. The businessman usually does not face any problem of funds as he may be in a position to invest his previous years' profits and/or he may also borrow.
2. The businessman still remains at the top of the management ladder as there is no major change in the organisation structure.
3. The businessman may avail of economies of scale.
4. It opens up opportunities for competition.
5. The businessman is in a position to use the existing resources in a better way due to large scale production.

Disadvantages of expansion

1. Growth is slow and gradual. It is not instant.
2. The businessman may have paucity of funds if he does not have enough of his own resources to invest in various assets. In that case if he wants to carry out expansion programme he will have to knock at the doors of financial institutions for availing loans.
3. The businessman may hesitate to expand and increase the volume of output because he may not have that much strength to counteract the moves of his competitors.
4. There may be limited scope of expansion in the present product market.

ii) Diversification

By now, we all know that growth is natural and gradual. A businessman in order to grow may increase the sale of existing products and may explore new markets for existing products or modify his products. These efforts will lead him to better utilisation of existing resources and more of profits. After some more time, he may reach a point where it is no longer possible to expand in the present product

market. A better option for him would be to add new products or markets. This method of growth is known as diversification.

Diversification is nothing but trying new areas and new products i.e. entering new fields of business. For example, a tea manufacturer may diversify by entering sugar industry, or hotel industry.

Advantages of diversification

1. The businessman can utilise his resources in a better way.
2. He can balance the decline of sales in his present product.
3. There can be reduction of risk by developing a balanced portfolio of business.
4. Cash surplus of one business can be used to finance another business.
5. There is an increase in competitiveness of a firm.

B. External Growth Strategies

A business unit can grow by joining hands with another business firm. This is how a businessman grows externally. It is also called as integrative growth strategy.

A firm may grow externally through:

- i) Joint Ventures
- ii) Mergers

These external growth strategies are detailed below:

i) Joint ventures

Joint venture is another form of partnership between two business units. Here, two or more independent business firms join hands by contributing to total equity capital and by participating in the business operations together. It is usually for a specific purpose. It may also be called as temporary partnership meant for a limited purpose.

Advantages

1. When two business units join hands, it may result in the end of wasteful competition.
2. Reduction in production and marketing costs through more sales.
3. Risk is divided among the co-venturers.
4. Amount of investment is shared by two or more firms.
5. Better utilisation of resources.
6. Better control over market.
7. Economies of scale.

Disadvantages

1. Changes in organisation structure and management.
2. Lack of co-ordination among co-venturers.
3. Large amount of funds may be required.

ii) Mergers

Merger is another type of growth strategy. Integration/Combining of two or more firms into one is known as merger. It may be through take-over of one company by another or by creating a new company by full consolidation of two or more separate companies.

There may be a combining or merging of two or more firms engaged in the same production (e.g. Brooke Bond and Lipton merged together and formed a new company known as “Brooke Bond Lipton India Limited”) or there may be a combination where combining units are complementary to each other.

In the process of merger two firms engaged in dissimilar lines may also combine. But this is not common.



Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Read the following extract given in the box and answer the questions given thereafter:

Hindustan Milk Food Manufacturers Limited was incorporated in 1958 to manufacture health food drinks. In the following decades the company underwent successive rounds of name changes following merger of associating companies. In December 2000, the associate company SmithKline Beecham Pic. merged globally with Glaxo Wellcome and formed Glaxo SmithKline Pic. In 2002, the brand created history by re-launching “Boost” with “power boosters™”, a product completely different from any other health food drink.

The company is working on products with further value addition, enlarging its presence in rural markets and developing a sizeable export plank.

- a) Mention the names of the two companies which have been merged.

- b) The name of the merged company is:

- c) Name of the product which was re-launched is:

- d) Which new market is the company trying to enter?
.....
- e) Is the company trying to make its presence feel in the international market?
.....
- f) Name the strategy adopted by the companies to grow.
.....

2. State True or False:

- a) Expansion can be financed from the firm’s own funds.
- b) Growth is always fast.
- c) Expansion involves additional risk.
- d) Market penetration and market development are the same.
- e) Development of new product is to meet the needs of the customers.

3. Mention any two advantages of diversification.

.....
.....

4. Fill in the blanks

- a) strategy aims at increasing sales of existing products in the current market.
- b) involves development of new product for existing market for new competitive advantage.
- c) The strategy represents an effort to bring existing product into new market.

16.5 STAGES OF GROWTH AND CHALLENGES FACED BY THE ENTRPRENEURS

Every organisation follows some pattern of growth. Some businessmen may experience no growth at all and may have to leave the arena soon. On the other hand there may be a few who experience slow growth while there may be others who feel that their business is expanding at a very fast rate. Usually, at the commencement of the business, the rate of growth is slow. Gradually, as the business gains momentum the rate of growth quickens. The businessman at this time plans to expand the customer base and product line. As time passes, the entrepreneur may face sharp competition which may reduce the rate of growth. Market may become saturated as well. Some entrepreneurs may be forced to think that the period of decline is not far away and they would be ousted if certain revival measures are not taken. The businessmen are faced with new challenges and responsibilities as and when their venture transits from one phase to another.

In the following paragraphs let’s now try to understand the different stages of growth and the various challenges which the businessman has to face at every stage.

Various Stages of Growth

Various stages of growth are as under:

1. Inception
2. Growth
3. Maturity
4. Decline

These stages of growth are discussed below:

1. Inception

The first stage starts with the discovery of an idea by the entrepreneur. He i.e. the entrepreneur is also known as the founder or the pioneer as he is the one who takes the lead. Here he is just like a sprinter who plans, trains, develops strategies and gets prepared both physically and mentally to run. Similarly, an entrepreneur does the spade work before starting the business. He may undertake the following kinds of studies during this period:

i) Study regarding the product

- Feasibility of the product.
- Designing of the product.
- Investigation regarding development costs, etc.

ii) Study of the market

- Who will buy the product?
- What can be the price?
- Will there be scope for the long term growth, etc.

iii) Study of finance

- Amount of personal savings.
- Availability of short term and long term loans, mortgage of property etc.
- Amount of seed capital required.

iv) Implementation

- Decide business location.
- Obtain licences from various agencies.
- Purchase machinery.
- Appoint employees.
- Sign agreements etc.

At this stage the sales are at the lowest; profits may or may not be earned; the firm may run out of cash; the rate of growth will be very slow and also it will be inconsistent, competition is uncertain. Usually a businessman offers only a single product at this stage and may cater only to a single market. The product is usually targeted to narrow market niches.

Many businesses come to an end during the stage of inception itself. In other words they do not reach the next stage of expansion at all. Can you think of the reasons? Well, it can be due to 'no planning' or 'wrong planning'; no feasibility plan made; lack of confidence; lack of vision; lack of business qualities; lack of capital; lack of market research, etc.

To avoid such failures, at the stage of inception, he should try to keep the price as low as possible, to cover the bare cost of the product. He should make a proper feasibility plan. He should also be very clear about the purpose of the project. He should try to build selective distribution system and try to build product awareness among early adopters and dealers. The psychological characteristics of the founder will largely determine how the venture will progress through this stage. The founder should have proper business plan. He should not rely on intuitions, he should be optimistic, energetic, and have the vision and foresight to wade through this initial stage which is full of problems and difficulties.

The businessman may also use heavy sales promotion schemes to attract trial.

2. *Growth*

A company can grow at a slow pace or at a very rapid rate. There may be business units which may have great potential for growth but the businessman himself may not be interested in further expansion. For example, a grocery-store owner may have no desire to expand beyond his capacity to own and manage a store personally.

In this stage the business can be transformed from a single-line enterprise operating in a limited market to a multi-line company penetrating new market. At this stage sales have a fast growth, profits are generally at the peak level, the competition is moderate, the product line is widened through innovation and development. Enterprises are enlarged. Due to expansion departments are created and authority delegated. There is decentralization.

To cope with this stage of growth the businessman requires effective leadership and vision. He should make well defined plans and should expand through strategic implementation of the plans. The business must be positioned to achieve long term objectives. He may launch new products or may enter new markets or may do both. He may have to provide better services, offer warranties, adopt penetrating price strategies, build intensive distribution system, and create interest in their product on a mass scale.

As the organisation expands the personal skills of the founder alone may not be sufficient. The organisation needs business related skills, functional expertise, marketing and operational skills etc. These decisions are beyond the scope of one person. Therefore, the personally managed firm may have to take the shape of professionally managed companies. The new activities will include marketing, cash flow management, inventory control, credit management, human resource development, logistics and distribution, management accounting etc. Decisions at this stage have to be based on systematic plans and through competitive evaluation and industry, market and the company. In a nutshell the businessman should be an able planner and he should be able to accept leadership roles which would be quite different from his role as a founder manager.

3. *Maturity*

Rapid growth cannot continue indefinitely. There will come a time when the market may become saturated. Competition is intensified; the businessman would be faced with marginally smaller incremental share of market. This is the period where maturity sets in.

The rate of growth is slowed down, capital becomes scarce, sales growth continues but at a diminished rate, profits start declining, many competitors enter the field. The weaker companies at this stage may fail or may be sold of. The businessman may reduce his product line or retreat from marginally profitable market. There may be a need to reduce the staff to streamline the distribution system and to withdraw from high risk market. The businessman may try to revise his business through innovative products. Re-positioning of product can also be tried. The company can utilise its resources towards research and development programmes.

4. Decline

If revival efforts are short-lived or ineffective the last stage i.e. decline sets in. Successful businessmen will not complete the life cycle because they will avoid decline. At this stage of decline, the sales will be very low and so the profits. There will be few new customers and no growth of business. The reasons for this decline can be many. The product of the businessman may have gone obsolete, the management may be inefficient. Ineffective leadership and lack of vision can be yet another reason for this disaster. For small business units, this phase is very difficult to handle due to very limited resources. Re-allocation of limited resources is the need of the hour. The businessman may have to take the help of professional managers who will identify the focal activity on which the future of the unit can be built. The stage of decline can be reversed through discovery of new uses of the product, appearance of new users, introduction of new features in a product etc. Decline may also occur if there is no successor to see the show. The life of the venture is limited to the working life of its founder businessman. For example, a retail store or a small manufacturing firm may be sold or closed down for want of competent successors.



Check Your Progress Exercise 3

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Fill in the following table:

| Variable/stages of growth | Inception | Growth | Maturity | Decline |
|---------------------------|---------------|------------------|-----------------------|------------------|
| Sales | Slow | ----- | Slow | ----- |
| Product | ----- | Multiple product | ----- | Obsolete product |
| Market | Single Market | ----- | High potential market | ----- |
| Profits | ----- | Peak | ----- | Low |
| Competitors | Few | Growing | ----- | Declining |

2. Choose the odd one out:

- i) At the inception stage, the businessman will –
 - (a) design the product;
 - (b) investigate development cost;
 - (c) decide location of the plant;
 - (d) create various departments.

i)
- ii) At the growth stage, the businessman will –
 - (a) penetrate new market;
 - (b) delegate authority;
 - (c) obtain licences from various Government agencies;
 - (d) provide leadership to his employees.

ii)
- iii) At maturity stage the businessman will –
 - (a) face paucity of funds;
 - (b) reduce product line;
 - (c) encourage research and development programme;
 - (d) close down his business.

iii)
- iv) At decline stage the businessman will –
 - (a) streamline distribution system;
 - (b) have obsolete product;
 - (c) will have inefficient management;
 - (d) will have lack of vision.

iv)

3. Match the following:

| Stages | Challenges |
|---------------|--------------------------------------|
| i) Inception | A. To allocate limited resources. |
| ii) Growth | B. To reposition product line. |
| iii) Maturity | C. To plan organizational structure. |
| iv) Decline | D. To do break-even analysis. |

16.6 LET US SUM UP



Growth is universal in nature. It is found everywhere around us. As human beings pass through the stages of infancy, childhood, adulthood and old age, similarly a business firm also passes through various stages of growth. Business growth is a natural and ongoing process. A businessman can judge the growth of his business through various parameters like increase in net

worth; increase in total assets; increase in volume of output, etc. A businessman is motivated to grow so that he can survive in the market. He can avail several economies of large scale production like lower overheads, strong bargaining power, etc. He can earn more profits and can make use of modern technology if his business keeps on growing. The growth strategies which the businessman usually follows may be categorized as internal growth strategies and external growth strategies. The former includes expansion and diversification while the latter includes joint ventures and mergers. The business firm usually follows some pattern of growth. Some businessmen may experience no growth at all while others a slow growth. Still there may be others who may experience that their business is expanding at a very fast rate. Various stages of growth of a business firm include inception, growth, maturity and decline. It is not necessary that every business will experience decline stage. Much depends upon the vision and foresight of the persons managing the organisation.

16.7 KEY WORDS

| | | |
|----------------------------|---|--|
| Trade cycles | : | Business cycles i.e., a period of boom followed by a period of depression. |
| Seed capital | : | Amount required for product development, market research, initial operating expenses before sales begins. |
| Market niches | : | A carefully defined segment of a broader market. |
| Cash flow statement | : | A financial statement that accounts for actual cash received and spent in the course of doing business. |
| Feasibility plan | : | An initial written plan comprising all the elements of a good business plan with the objective of determining whether a new venture is expected to succeed. |
| Innovation | : | Transformation of creative ideas into useful application by combining resources in new or unusual ways to provide value to society for new or improved products, technique or service. |



16.8 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

- Strong bargaining power
 - Economy in freight
- Increase in net worth of the firm
 - Increase in the volume of output
- Modern technology
 - Personal factor

Check Your Progress Exercise 2

1.
 - a) SmithKline Beecham Pic. And Glaxo Wellcome
 - b) Glaxo SmithKline Pic.
 - c) Boost
 - d) Rural markets and export
 - e) Yes
 - f) Merger

2.
 - a) T
 - b) F
 - c) T
 - d) F
 - e) T

3.
 - i) Utilisation of resources in a better way.
 - ii) Reduction in risk by developing a balanced portfolio of business.

4.
 - a) Market penetration
 - b) Product development
 - c) Market development

Check Your Progress Exercise 3

1.

| Variable/ stages of growth | Inception | Growth | Maturity | Decline |
|---|---------------------------|----------------------------|-------------------------------|----------------------|
| Sales | Slow | <u>FAST</u> | Slow | <u>NEGATIVE</u> |
| Product | <u>SINGLE PRODUCT</u> | Multiple product | <u>INNOVATIVE PRODUCT</u> | Obsolete product |
| Market | Single Market | <u>MULTIPLE MARKET</u> | High potential market | <u>NO MARKET</u> |
| Profits | <u>NEGLIGIBLE</u> | Peak | <u>DECLINING</u> | Low |
| Competitors | Few | Growing | <u>MANY</u> | Declining |

2.
 - i) (d)
 - ii) (c)
 - iii) (d)
 - iv) (a)

3.
 - i) D
 - ii) C
 - iii) B
 - iv) A

16.9 SOME USEFUL BOOKS

1. David H. Holt (2002) Entrepreneurship – A New Venture Creation, Ed., Prentice Hall of India Private Limited, New Delhi
2. Gupta, C.B. and Khanka, S.S. (2004) Entrepreneurship and Small Business Management, Ed., Sultan Chand and Sons, New Delhi.
3. Varshney, R.L. and Gupta, S.L. (2000) Marketing Management (An Indian Perspective), Ed., Sultan Chand and Sons, New Delhi.

16.10 ASSIGNMENTS

1. Mention any two challenges which a businessman may face at the first two stages of growth.
2. Mention the various stages of growth.
3. Why does the businessman try to widen his product line through innovations while expanding?
4. Is decline of a business inevitable? Give two reasons to support your view.
5. What could be the various reasons for closure of a business firm:
 - i) at inception stage;
 - ii) at decline stage.
6. What is a joint venture? How is it different from mergers?
7. “Growth is slow and steady”. Discuss.
8. Mention four advantages of diversification of business.
9. “Market development is different from market penetration”. How?
10. A businessman is motivated to grow due to multiple factors. Discuss the various factors.

UNIT 17 INTERNATIONAL MARKETS: SCOPE FOR SMALL ENTERPRISES

Structure

- 17.0 Objectives
- 17.1 Introduction
- 17.2 Knowledge about the Market
- 17.3 Opportunities offered by the International Markets
- 17.4 How to Enter International Markets?
- 17.5 Export Concessions, Incentives and Promotional Measures
- 17.6 Export Pricing and Export Documents
- 17.7 Let Us Sum Up
- 17.8 Key Words
- 17.9 Answers to Check Your Progress Exercises
- 17.10 Some Useful Books
- 17.11 Assignments

17.0 OBJECTIVES

After studying this unit, you should be able to:

- understand the distinct characteristics associated with international marketing;
- get an insight into the target market;
- identify various business opportunities, offered by the international markets;
- describe the various routes through which international markets may be accessed;
- understand the various export incentives; and
- comprehend export pricing and export documentation.

17.1 INTRODUCTION

When a businessman crosses national boundaries for purchase and /or sale of goods and services, he enters international markets. Purchase of goods from international markets is called 'import' and sale of goods thereto is called 'export'.

All the activities, which take place in the domestic market, are also associated with international marketing. Thus, a businessman operating in international market shall have to identify correctly, assess and interpret the needs of the buyers in the foreign country and make marketing effort to satisfy those needs. However, there are certain distinct characteristics, which are associated with the international marketing only. These are:

Rules and regulations framed by the Government: A businessman desiring to enter the international market has to follow complex formalities relating to customs, foreign exchange etc. He should have full knowledge of rules and regulations governing foreign trade. Documentation part of foreign trade is much more complicated. All these formalities require expense of time and money.

Different languages and customs: There may be some communication barriers because each nation has its own language and customs. Though English is the common language used yet in certain countries people use their own language.

Transit risk: Trading in international market implies that the goods have to undergo long transportation route before they reach the destination. An all-proof packing is a must for the exportable goods. Modes of transport used, in the case of foreign trade is land air or sea. In these modes of transport transit risk is always on the higher side. The goods must be insured before despatch.

Problem of foreign exchange: The currency circulating in the importing and the exporting country is not the same. The currency of one country is considered as a commodity in the other country. Thus, in the case of foreign trade there always remains the problem of exchange of currency. There is a risk associated with the exchange rates, which are always fluctuating. Settlement of accounts between the exporter and the importer may create certain difficulties.

Creditworthiness of the customers: Due to the distances involved the exporter and the importer hardly meet physically. In the absence of any meeting exporter has to depend upon the references for ascertaining the creditworthiness of his customers. The exporter is not certain whether he has obtained the correct picture of his customer.

Blocking of capital: The capital of the businessman remains blocked for comparatively longer period of time because payments are not realized immediately. A number of intermediaries are involved in the case of foreign trade. This results in longer time gap between dispatching of goods and ultimate realisation of payments from the importers.

17.2 KNOWLEDGE ABOUT THE MARKET

Knowledge of the product in which the businessman wants to deal is important but at the same time knowing the target market (in this case the foreign market) is equally important. It has been observed that the most successful exporters remain in constant touch with the market.

Defining the Market

A businessman has to define the geographic location of his potential market. It may be just across the border i.e. neighbourhood or a far off city or a particular region or the whole country. If the businessman knows his market clearly he may be in a position to focus his marketing efforts. Following points need attention of a prospective exporter:

- Potential customers of the product and why they need the product.
- In which way the product is new to the market or different from the product available to it.
- In which way the product is more desirable.
- What are the chances that the product will be accepted or rejected in the prospective market?
- Prepare a list of prospective market areas. These should be the areas where the exporter thinks that his sales programme for the product may find support.

- A testing of prospective market areas may be done with a view to determine where marketing efforts will be more productive.

Initially, it will be more appropriate to deal in a small, geographic locality and thereafter extend the market to keep the cost of operations reasonable.

What Constitutes the Prospective Market

The businessman should find out what? before exporting his product the type of customer and the business. For example:

- Does the target customer belong to a particular age, social or economic group?
- Is the target customer more interested in quality and durability of the product?
- Is the target customer already buying a similar product, which is offered for sale or he is to be educated regarding the uses of product?
- Which of the needs of the target customer will be fulfilled by the product offered for sale?
- Is the target customer likely to haggle/bargain?

Keeping Track of Movements of Exportable Product

The businessman should know beforehand as to when demand for his product arises in the international market. Knowledge of seasonality of demand is very important. If the businessman knows the timing when his product is needed, say near a particular festival time, he should schedule his operations backwards from that date so that supplies are made available well before that festival. The following movements of merchandise may take several weeks (and even months) for completion:

- Movement of goods from importer's warehouse to retailer's warehouse in the importing country.
- Clearance of goods through foreign customs.
- Transporting of goods from the point of manufacture to the port of export.
- Manufacturing time required for producing the goods.
- Preliminary research, planning etc.

All the above tasks may take much longer time than expected and therefore a track of movement of merchandise must be kept.

Conducting Market Research

The businessman should conduct market research in one form or the other on a continuous basis. Good business planning is not possible if no market research is conducted on regular basis. At present it is a buyers' market and not a sellers' market. There is always a need to secure information on the needs and preferences of consumers. It must be the endeavour of the exporter constantly to analyse what is happening in the market place.

Contacting Potential Customers

The businessman needs to know his potential customers. If he knows his market and the customers well, he will be in a position to offer what they need

Assessing Performance

rather than what he wants to sell. In other words a rapport with customers is a must. He may ask his potential customers in the foreign market:

- What is your requirement?
- What is selling well? What features will make for good sales?
- What price would the market bear?
- What terms of sale would you require?

The exporter should find out the stores and businesses they are already interested in goods from his country or are dealing with products in the same line on his intended exports as his potential customers one likely to be found among them.



Check Your Progress Exercise 1

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Fill in the blanks:

- i) Purchase of goods from international markets is called -----.
- ii) Sale of goods to international markets is called -----.
- iii) Modes of transport used for foreign trade include ----- and -----.
- iv) ----- should be conducted on regular basis for good business planning.
- v) In foreign trade capital invested remains blocked for comparatively longer period of time due to number of ----- involved.

2. Mention two distinct characteristics of foreign trade.

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3. Why does an exporter need to know his potential customers?

.....

17.3 OPPORTUNITIES OFFERED BY THE INTERNATIONAL MARKETS

International markets offer a number of opportunities to a businessman. They are listed as below:

i) *Scope for bulk sales*

Usually export orders are much larger than those emerging from the domestic markets. Sometimes a single export order may far exceed the total supply made by the firm in a year in the domestic market. The businessman has, thus, the opportunity to go for bulk sales.

ii) Scope for full utilisation of installed capacity

Sometimes it may happen that the businessman has got the installed capacity but the same cannot be utilised fully because there is no sufficient demand in the domestic market. Export business provides a suitable opportunity to use the installed capacity to its full extent.

iii) Scope to overcome recession in the domestic market

The businessman may face recession in the domestic market for his product. To overcome recession international markets provide a golden opportunity. Recession serves as a stimulus to various export opportunities. The businessman can venture to enter the international markets and create a place for his products.

iv) Scope to overcome legal restrictions in the domestic market

Sometimes it may happen that the Government might impose certain restrictions in the domestic market on sale of certain products or on the further growth of particular firms. However, this problem may be sorted out by resorting to exports i.e. accessing international markets. Even the exports may help the businessman to earn export incentives from the Government.

v) Scope for technological advancement

A businessman opting for international market might be enabled to pick up new product ideas and to add to the existing product line. Exports provide the chance to go for technological advancement, which may help the businessman to improve his product. Improvement in products will help in reducing costs and also discovering new uses of the product. This can even help in capturing more share of domestic market.

vi) Scope for diversifying business risks

Entry into the international market provides an opportunity to the exporter to diversify his risks. At times, domestic market may show downward fluctuation in sales resulting in low turnover and profits. This may be offset if the businessman opts for exports and targets international market to boost his sales. This is nothing but geographical diversification. The businessman can attain growth in his business by adopting this kind of diversification because a single market may not give adequate profits.

vii) Scope for increase in production

Survival needs of a business require increase in production. The firm will go for increased production if there is scope for absorption of its product. International markets present an opportunity for absorbing increased production if it is up to the international standards. The businessman may opt for markets in developed and developing nations for supplying his product. Production at large scale helps the firm to derive economies of scale and reduce the cost of production.

Check Your Progress Exercise 2

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. State True or False against each:
 - i) There is no scope for bulk sales in case of foreign trade.
 - ii) Export business helps in utilizing installed capacity to its full extent.
 - iii) Recession in the domestic market does not serve as a stimulus to various export opportunities.
 - iv) International markets enable a businessman to pick up new product ideas.
 - v) Risks can be diversified by entering international markets.
2. Mention two opportunities available if the businessman enters international markets.
 - i)
 - ii)
3. “International markets present an opportunity for absorbing increased production”. Comment.

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17.4 HOW TO ENTER INTERNATIONAL MARKETS?

A businessman can enter international markets by following any of the following routes mentioned below:

- I. Indirect Route
- II. Direct Route
- III. Other Miscellaneous Routes

Let’s now discuss these routes in detail.

I. Indirect Route

In this case the businessman does not enter international markets on his own. He takes the help of merchant exporters for exporting his products. These merchant exporters are usually recognised as star export houses (categorised as one star export house, two star export house, three star export house, four star export house and five star export house – in terms of Foreign Trade Policy 2004-2009).

Export houses are also interested in promoting the exports of goods originating from units in small-scale industry, Tiny sector, cottage industry sector and units registered with KVICs or KVIBs. This is so because, for being recognised as star export houses, these merchant exporters are required to achieve certain export performance. In case they export goods

originating from above type of units, they are entitled for double weightage of such exports in calculating their export performance. Further export of agro-products also entitles them to double weightage.

- *Benefits of Exporting Products through Star Export Houses*
 - i) *Gain from wide knowledge and experience:* These merchant exporters have wide knowledge and experience about the products, which have an export market. Similarly, they know the international markets, trends prevailing there much better.
 - ii) *Availability of finance:* The manufacturers can obtain pre-shipment finance from the export houses as in deserving cases they extend financing facility to their supporting manufacturers. Similarly, the manufacturer can obtain pre-shipment and post -shipment finance from banks on the guarantee of merchant bankers.
 - iii) *Less financial risk:* There is less financial risk involved while exporting goods through export houses because generally they (i.e. export houses) make payment to the businessman as soon as he delivers the exportable goods to them.
 - iv) *Invaluable advice regarding characteristics of international markets:* Merchant exporters can advise the manufacturers regarding production pattern, packing standards, quality requirements and other important characteristics of international markets. Based on the advice, the manufacturer can bring out a product acceptable in the overseas market.
 - v) *Dealers' network:* Most of the merchant exporters have a dealers' network and sales organisations operating in many international markets. Through these organisations and the network they can provide exporting opportunities to the businessman.
 - vi) *Valuable guidance regarding product development:* Merchant exporters can provide valuable guidance to the businessman with regard to product development so that exportable products match the international standards. At times they may even give samples of exportable products.
 - vii) *Better terms for shipping and insurance:* Shipping and insurance play a major role in exports. The merchant exporters can secure better terms from shipping and insurance companies as compared to the businessman if he wants to act on his own. This is so because the merchant exporters have their own arrangements with these companies and therefore they are in a position to obtain better deals for their clients. At times, merchant exporters combine several shipments from various firms and the goods are shipped that way. This helps in reducing transporting charges considerably.
 - viii) *Professional handling of export documentation:* In case of exports, lot of shipping and documentation work is involved, which the merchant exporters can handle more professionally.

II. Direct Route

Export of goods through merchant exporters may not always be beneficial. The main drawback is that the businessman does not get the chance to create goodwill for his our product and brand name. Also he gets less net

return on sales to allow for the profit of merchant exporter. He is not recognised in the international market though his product is exported. You will note that success in the international market as exporter may help him in boosting his image in the domestic market also. Keeping these facts in view the businessman may opt for direct exporting. In this respect he may take the following steps:

i) Try to establish contacts with big departmental stores

The businessman should try to establish contacts with the big departmental stores in the developed as well as developing countries. Departmental stores keep a variety of products like grocery items, ready-made garments, electronic gadgets, leather goods, jewellery items etc. The key persons to be contacted there may be few. If the product to be exported is of good quality, the businessman may use his personal selling techniques and be in a position to convince one or two such departmental stores to purchase his product. If he succeeds in his endeavour and his product finds way into such departmental stores and the sales of that product at that end picks up it will boost his performance and reputation. There are chances that other departmental stores may also come to know of that product and may place orders for supply. Thus, he will get more and more business.

ii) Try to establish contacts with institutional buyers

In every country there are institutional buyers like hospitals, government establishments, hotels, educational institutions etc. In every such institution there is a particular department or key person who purchase the supplies. Here, the businessman has to use his personal selling techniques and thereby establish contacts and persuade the persons concerned to purchase his product. If he succeeds he may secure large export business.

iii) Direct exporting through co-operative societies

Forming of co-operative societies by persons having common interest is quite usual in various countries. The members of these co-operatives try to secure better terms for purchasing their requirements. Here also, the key persons to be contacted may be few. In case the businessman is good at personal selling with additional requirement that he produces a qualitative product, he may hope to secure large export orders.

iv) Overseas sales agents

Overseas sales agents play an important role in establishing contacts with the importers. They are always near the international markets. A sales agent may be a commission agent or a distributor. In case of commission agents, they secure export orders for the exporters. For their services, they receive an agreed rate of commission from the exporters. In case of distributors, they purchase the exportable products from the exporters. Thereafter, they sell the products on their own through the sale outlets owned by them. Overseas sales agents are very useful to the exporters inasmuch as they provide latest information for adopting right market strategy and guide the exporters in choosing a proper channel of distribution.

Note: It is advisable for a small-scale entrepreneur to undertake export through merchant exporters (i.e. indirect exporting) initially. After gathering enough experience regarding international markets, packaging of exportable products, export documentation, dealing with shipping companies etc. he could go for direct exporting.

III. Other Miscellaneous Routes

Besides indirect and direct exporting there are certain other options available through which entry into international markets may be made. These are stated as below:

- a) *Opening a branch office or subsidiary abroad:* The businessman may take steps to open a branch office in a foreign country or even subsidiary at that end. The work to be undertaken there may include processing of the product including assembly and packaging. In the course of time, as the business develops, even complete manufacturing may also be undertaken.
- b) *Going for joint ventures:* This is another option available and the businessman may go for joint ventures in foreign countries. Through the joint ventures he may undertake marketing of the product in that country. Manufacturing activities may also be undertaken depending upon the purpose for which the joint venture has been formed. In India a number of joint ventures where foreigners are involved, are operating successfully.
- c) *Providing consultancy services:* Another way of entering international markets is to provide consultancy services. A person having expertise in agricultural activities may offer expert advice to the foreigners in increasing the agricultural output. Consultancy services can be provided in other fields of business also. Persons providing consultancy services are known as consultants.
- d) *Technology transfer:* The businessman may enter into contract with the foreigners for supply of technology. A franchising agreement may be entered into in this respect. Similarly patents, trademark etc. of the exporting firm may also be used by the overseas buyers.

Check Your Progress Exercise 3



Note: a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. Name the following:

- i) a merchant exporter who helps the businessman in exporting his products.
- ii) a person who works on commission basis in the international markets.
- iii) a person offering consultancy services to the foreigners.
- iv) a person who purchases goods from the exporters and sells them on his own in the international market.
- v) A store which keeps a variety of products and which can be contacted by the exporter.

2. Explain the other miscellaneous routes of entering into international markets.

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17.5 EXPORT CONCESSIONS, INCENTIVES AND PROMOTIONAL MEASURES

In India, the Government has encouraged exports to a considerable extent. A number of export concessions and incentives are available to the exporters – no matter whether they are working on a small scale or large scale. Till 2004, Government had operated EXIM Policy for promotion of exports. Now it is Foreign Trade Policy 2004-2009, which will provide export promotion measures. In the following paragraphs we will study about these concessions, incentives and export promotional measures.

i) Export Finance

Banks have been authorised to provide export finance to exporters at concessional rates. Finance is needed both for the manufacture of exportable goods and after the shipment of the goods. These are termed as pre-shipment finance or packing credit, and post shipment finance. Under pre-shipment finance facility, the exporter obtains finance for purchase, processing, manufacturing, or packing of goods for export purposes. Under post-shipment finance facility, the exporter obtains finance to cover the time to receive payment after the shipment of goods.

ii) Duty Exemption/Remission Schemes

These schemes facilitate import of goods for export production. *Duty exemption schemes* enable duty free import of inputs required for export production. The process starts by issue of an advance licence for duty free import of inputs. The advance licence is issued subject to the actual user condition. Therefore, advance licence and material imported thereunder shall not be transferable even after completion of export obligation. The licence can be issued for physical exports, intermediate supplies and deemed exports.

A duty remission scheme enables post export replenishment / remission of duty on inputs used in the export product. These schemes consist of Duty Free Replenishment Certificate (DFRC) Scheme and Duty Entitlement Pass Book (DEPB) Scheme. DFRC permits duty free replenishment of inputs used in the export product. DEPB allows drawback of import charges on inputs used in the export product.

iii) Export Promotion Capital Goods (EPCG) Scheme

Under this scheme import of capital goods is permitted. These capital goods are to be used for export production. New capital goods including computer software systems can be imported under EPCG scheme. The import is permitted at a concessional customs duty rate of 5%. However,

export obligation equivalent to 8 times of customs duty saved on capital goods imported under the EPCG scheme shall be fulfilled over a period of 8 years. The period for fulfilling export obligation shall be increased to 12 years if the duty saved is Rs. 100 crores or more. For exports of agricultural products and their value added variants, import of capital goods would be allowed at 0% duty.

iv) Duty Drawback (DDB) Scheme

For the production of export goods raw materials and components are used on which excise duty/customs duty is paid. Under *Duty Drawback Scheme* excise and customs duties paid on raw materials and components used for producing export goods are refunded to the exporters once the exports materialise.

v) Deemed Exports

In case of deemed exports, goods supplied or sold do not leave the country. This is possible when the goods are supplied to some particular establishments like units located in EPZ, 100% EOUs, projects funded by United Nations Agencies or multilateral or bilateral agencies, power projects and refineries, etc. in India. Payment for these supplies is received either in Indian rupees or free foreign exchange. Deemed exports are eligible for following benefits:

- a) Advance licence for intermediate supplies/deemed exports/DFRC/DFRC for intermediate supplies.
- b) Deemed export drawback.
- c) Exemption / refund of terminal excise duty.

vi) Market Development Assistance (MDA)

Under MDA scheme, assistance is provided to the exporter for marketing his products in the international markets. You know that export marketing requires heavy investments. Exporters on their own may not be in a position to market the products. To help them out in marketing of export products, MDA has been devised. As per the revised Guidelines effective from April, 2004 assistance under MDA is available to exporters with annual export turnover up to Rs. 5 crores. The marketing development assistance is provided for the following purposes:

- a) Individual sales-cum-study tours/trade delegations abroad.
- b) Individual participation in trade fairs, exhibitions and buyers-cum-sellers meets abroad or in India.
- c) For conducting Export promotion seminars.
- d) Publicity and advertisement.
- e) Other specified activities.

vii) Taxation Relief

For promoting exports income tax exemption is available. However, the income tax exemption scheme is going to be phased out over a period of five years by 2004-05. It is provided that the scheme shall remain operational for the units located in EPZs and in case of 100% EOUs. As regards sales tax, the same is not to be levied in case of export sales. Goods meant for export can be purchased without payment of sales tax against issue of Form H. Further excise duty is not leviable on and if paid is refunded to the exporters.

viii) *Export Processing Zones (EPZ)*

With a view to provide an internationally competitive duty free environment for production of exportable goods, EPZs have been set up. Units located in EPZs get infrastructural facilities for manufacturing products at lower cost. They need not obtain import licence for importing capital goods, raw materials etc. Excise duty is exempted on capital goods and raw materials purchased from the domestic market.

ix) *100% Export Oriented Units (100% EOUs)*

A businessman can set up these types of units anywhere in the country. 100% EOUs are required to export their entire production except some permitted portion, which can be sold in the domestic market. Similar facilities which are available to units located in EPZs are also available to 100% EOUs. An EOU engaged in agriculture, floriculture or horticulture may be permitted to remove specified goods in connection with its activities for use outside the bonded area.

x) *Special Agricultural Produce Scheme (Vishesh Krishi Upaj Yojana)*

This Scheme has been announced in the Foreign Trade Policy 2004-2009. The objective of the Scheme is to promote export of fruits, vegetables, flowers, minor forest produce, and their value added products. Exporters of such products shall be entitled for Duty Credit Scrip equivalent to 5% of the FOB value of exports for each licensing year commencing from 1st April 2004. The exporters can freely transfer the scrip and the items imported against it. Further, the Duty Credit may be used for import of inputs or goods including capital goods.



Check Your Progress Exercise 4

- Note:** a) Use the space below for your answer.
 b) Compare your answers with those given at the end of the unit.

1. Write full forms of the following abbreviated schemes:

- i) DEPB Scheme -----
- ii) DFRC Scheme -----
- iii) EPCG Scheme -----
- iv) MDA Scheme -----
- v) DDB Scheme -----

2. Following paragraph, which relates to ‘Export Finance’, contains certain blanks. You are required to fill in the blanks with appropriate words:

‘Banks have been authorised to provide export finance to exporters at ----- rates. Finance is needed both for the manufacture of ----- goods and after the shipment of the goods. These are termed as ----- finance or packing credit, and ----- finance. Under the facility, the exporter obtains finance for purchase, -----, manufacturing, or ----- of goods for export purposes. Under post-shipment finance facility, the exporter obtains finance for the purpose that it may take sometime to receive ----- after the shipment of goods.’

Export Pricing

Export pricing is the most important factor, which a businessman must consider for success in the international markets. There are some specific issues associated with export pricing which are not present in the domestic pricing of a product. These are as under:

i) *Currency for export pricing*

In India, the businessman can quote the price of his product in rupees but when he goes into the international market there arises a question – in which currency he should quote the price. Exchange rate fluctuations can increase or decrease the export profits to a significant extent. A stable currency should be considered for export pricing.

ii) *Consideration of inflation*

Every country in the world is in the grip of inflation. Prices of the products are affected by the inflationary conditions. Therefore, to counteract the inflation, pricing policy should be so designed that it takes into account the measures, which help in decreasing the impact of inflation. If the businessman faces high inflation rates, he may follow NIFO (Next in First Out) system.

iii) *Quoting of export price (Price quotations)*

In case of international marketing there are many ways in which export price may be quoted. These are as under:

- *Loco price*: Loco price, also known as ex-factory price includes the cost of production and the normal profit margin. In case of this type of quotation the foreign importer has to collect the goods from the seller's warehouse. The other expenses incurred for taking the goods to importer's place are to be borne by the importer.
- *F.O.R. (Free on Rail)*: In this type of quotation, the exporter quotes the export price, which includes the cost of goods, profit margin and the cost of carrying the goods to the railway station and loading them.
- *F.A.S. (Free along side ship)*: In this type of quotation, the exporter quotes the export price, which includes the cost of goods, profit margin, cost of carrying the goods to the railway station and loading them, and charges for placing the goods near the ship.
- *F.O.B. (Free on Board)*: In this type of quotation, the exporter quotes the export price, which includes the cost of goods, profit margin, cost of carrying the goods to the railway station and loading them in the wagons, and charges for loading the goods into the ship.
- *C. & F (Cost & Freight)*: This type of price quotation includes the F.O.B. price and the freight payable to the shipping company for transporting the goods to the importer's country.
- *C.I.F. (Cost Insurance & Freight)*: In this type of quotation, the exporter quotes the export price, which includes C&F price and the premium paid for marine insurance.

Assessing Performance

- *Ex-ship price*: In this type of quotation, the exporter quotes the export price, which includes all the expenses until the ship arrives at the port of destination.
- *Landed price*: In this type of quotation, the exporter quotes the export price, which includes ex-ship price and also the cost of unloading the goods from the ship.
- *FRANCO*: This type of price quotation includes all the expenses for delivering the goods at the warehouse of the importer.

Export Documents

There are certain principal export documents, which are required for transferring ownership of the goods from the exporter to the importer. There are certain other documents, termed as auxiliary export documents, which are required for the preparation of principal export documents. These export documents are stated below:

Principal export documents

- i) Commercial Invoice
- ii) Packing List
- iii) Bill of Lading
- iv) Certificate of Inspection
- v) Letter of Credit
- vi) Marine Insurance Policy
- vii) Certificate of Origin
- viii) Bill of Exchange

Auxiliary export documents

- i) Proforma Invoice
- ii) Intimation for Inspection
- iii) Shipping Instructions
- iv) Insurance Declaration
- v) Shipping Order
- vi) Mate's Receipt
- vii) Application for Certificate of Origin
- viii) Letter to the Bank for negotiation or collection of documents



Check Your Progress Exercise 5

- Note:** a) Use the space below for your answer.
b) Compare your answers with those given at the end of the unit.

1. The two factors, which influence export pricing, are as under:

- i)
- ii)

2. What are the full forms of following price quotations:

i) F.O.R. -----

ii) F.A.S.-----

3. What is LOCO Price? How is it different from FRANCO?

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.....
.....

17.7 LET US SUM UP



Doing business after crossing national boundaries means entering into international markets. Purchase of goods from international markets is called 'import' and sale of goods thereto is called 'export'. Before going for exports the businessman needs to know the target market. He should understand his customers, what type of product they need, whether the product he is offering fits into the category, which is in demand and so on. He is required to keep a track of the movements of his product, which he desires to export so that it is placed in the target international market at the right time. In this connection he should schedule operations backwards. A market research on regular basis is a must because at present it is a buyers' market and not a sellers' market. The businessman should remain in constant contact with his customers. International markets offer a number of opportunities like scope for bulk sales, full utilisation of installed capacity, overcoming of any legal restrictions or recession in the domestic market, diversification of business risks, increase in production etc. International markets may be approached either through indirect exporting or direct exporting but it is always better if a small entrepreneur initially adopts the route of merchant exporters for exporting his goods. Other routes of entering international markets include opening a branch office or subsidiary in the foreign country, going for joint ventures with foreign nationals providing consultancy services and transfer of technology. In India, a number of concessions, incentives and promotional measures are available for boosting exports. They include availability of export finance at lower rates of interest, duty exemption/remission schemes, EPCG scheme for import of capital goods, duty drawback scheme, deemed exports, market development assistance scheme, taxation relief, duty credit scrip to the exporters of horticulture produce, etc. Export pricing should be done keeping in view the specific issues associated with it. Depending upon the agreement reached between the exporter and the importer, export price quotation may be loco price, F.O.R., F.A.S., F.O.B., C. & F., C.I.F., ex-ship price, landed price or FRANCO. In the export of goods a number of documents are involved which may be categorised as principal export documents and auxiliary export documents.

17.8 KEY WORDS

- Joint venture** : A kind of business partnership between two firms to achieve a common purpose.
- Pre-shipment finance** : Finance availed from banks for manufacturing/procurement of exportable goods.

| | |
|-------------------------------|---|
| Post-shipment finance: | Finance availed from banks before realisation of export proceeds. |
| Subsidiary | : A company whose 51% or more share capital is held by another company. |



17.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

- | | | |
|----------------------|-------------------|---------------|
| i) Import | ii) Export | iii) Sea, Air |
| iv) Market research; | v) Intermediaries | |
- Applicability of rules and regulations connected with foreign trade.
 - Applicability of foreign exchange laws.
- Hint:** So that the exporter is in a position to offer what his potential customers need.

Check Your Progress Exercise 2

- | | | |
|----------|----------|------------|
| i) False | ii) True | iii) False |
| iv) True | v) True | |
- Scope for bulk sales
 - Scope to overcome recession in the domestic market.
- Yes. International markets present an opportunity for absorbing increased production. To achieve this, the businessman may opt for markets in developed and developing nations for supplying his product.

Check Your Progress Exercise 3

- | | |
|-----------------------|----------------------|
| i) Star export house | ii) Commission agent |
| iii) Consultant | iv) Distributor |
| v) Departmental store | |
- Opening a branch office; Entering into Joint Ventures: through technology transfer.

Check Your Progress Exercise 4

- Duty Entitlement Pass Book Scheme.
 - Duty Free Replenishment Certificate Scheme
 - Export Promotion Capital Goods Scheme
 - Market Development Assistance Scheme
 - Duty Drawback Scheme
- | | | | |
|---------------|-------------|---------------|----------------|
| concessional; | exportable; | pre-shipment; | post shipment; |
| processing; | packing; | payment | |

Check Your Progress Exercise 5

1. i) Currency ii) Inflation
2. i) Free on rail ii) Free along side ship
3. Loco price includes the cost of production and the normal profit margin whereas FRANCO price includes all the expenses for delivering the goods at the warehouse of the importer.

17.10 SOME USEFUL BOOKS

1. Bhushan, Y.K. (2001) Fundamentals of Business Organisation and Management, Ed., Sultan Chand and Sons, New Delhi.
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5. Varshney, R.L. and Bhattacharya, B. (2000) International Marketing Management – An Indian Perspective, Ed., Sultan Chand and Sons, New Delhi.
6. Varshney, R.L. and Gupta, S.L. (2000) Marketing Management (An Indian Perspective), Ed., Sultan Chand and Sons, New Delhi.

17.11 ASSIGNMENTS

1. What is foreign trade?
2. Mention any three benefits of export of goods through indirect route.
3. Explain the distinct characteristics associated with the international marketing.
4. Enumerate the areas where an exporter is required to focus his attention while defining his potential market.
5. International markets offer a number of opportunities to a businessman. How?
6. Name the various types of star export houses.
7. 'Export of goods through merchant exporters may not always be beneficial.' Why? Suggest any two ways through which an exporter may overcome this problem.

Assessing Performance

8. Write short notes on:
 - i) Duty exemption / remission schemes.
 - ii) Market development assistance.
9. Explain briefly the following export price quotations:
 - i) F.O.B. price
 - ii) C.I.F.
 - iii) FRANCO
10. State any five documents used in the export transactions.

EXERCISE 1 PREPARATION OF COST OF PROJECT AND MEANS OF FINANCE

Structure

- 1.1 Introduction
Objective
- 1.2 Statement of Cost of Project
Practical Example
Assumptions for Making Cost of Project Statement
- 1.3 Means of Finance Statement
Practical Example
Assumptions for making Means of Finance Statement
- 1.4 Important Considerations

1.1 INTRODUCTION

The estimation of cost of project and means of finance is very important and first steps for making an investment project viable and solvance. This exercise detailed about what cost items should be included and how much of money expenditure is required under each cost items. This exercise details about the various means of finance for the project.

Objective

After going through this exercise, you should be able to:

- prepare the cost of project and know the various means of finance.

1.2 STATEMENT OF COST OF PROJECT

In this statement, estimates regarding land and building, plant and machinery, pre-operative expenses, contingencies etc. are stated. Amount which the entrepreneur desires to allocate as working capital is also mentioned. Following is the proforma of Cost of Project Statement:

Format of Cost of the Project Statement

| Particulars | Total Rs. in Lac |
|--|---------------------|
| A. Land & Site Development | ----- |
| B. Building and Civil Works | ----- |
| C. Plant & Machinery and Utilities | ----- |
| D. Interest during construction period | ----- |
| E. Preoperative Exp. | ----- |
| F. Contingencies | ----- |
| G. Working Capital | ----- |
| Total | ----- |

1.2.1 Practical Example

Let us now have a look at the following practical example:

Cost of the Project

| Particulars | Total Rs. in Lac |
|------------------------------------|---------------------|
| A. Land & Site Development | 0.00 |
| B. Building and Civil Works | 0.00 |
| C. Plant & Machinery and Utilities | 20.00 |
| D. Interest during Const. Period | 0.00 |
| E. Preoperative Exp. | 0.50 |
| F. Contingencies | 1.00 |
| G. Working Capital | 7.26 |
| Total | 28.76 |

1.2.2 Assumptions for Making Cost of Project Statement

In this statement total cost of the project has been assumed to be Rs.28.76 lacs. It is assumed that the promoters are in possession of land as well as building. Therefore, no investment is to be made for this purpose. Rs.20.00 lacs are required to be spent for purchasing plant and machinery. Re.0.50 lac is required for pre-operative expenses. Re.1.00 lac is required for contingencies. Adding all these figures the cost of the project comes to Rs.28.76.

1.3 MEANS OF FINANCE STATEMENT

This statement indicates the means of finance i.e. as to how to bring in the money equal to the cost of the project. In this statement we show the promoters' contribution, loan which may be availed from the bankers and also contributions made by the relatives and friends in the form of unsecured loans. Following is the format of means of finance statement.

Format of Means of Finance Statement

| Particulars | Total Rs. in Lac |
|-----------------------------|---------------------|
| A. Promoters Capital | ----- |
| B. Unsecured Loans/Deposits | ----- |
| C. Loan | ----- |
| Total | ----- |

1.3.1 Practical Example

Let us now have a look at the following practical example:

Means of Finance

Preparation of Cost
of Project and
Means of Finance

| Particulars | Total Rs. in Lac |
|-----------------------------|---------------------|
| A. Promoters Capital | 11.00 |
| B. Unsecured Loans/Deposits | 2.76 |
| C. Loan | 15.00 |
| Total | 28.76 |

1.3.2 Assumptions for making Means of Finance Statement

The promoters are assumed to bring in Rs.11.00 lacs. The Rs.15.00 lacs shall be raised from bank as term loan. Remaining Rs.2.76 lacs shall be taken as unsecured loans from friends and relatives without interest.

1.4 IMPORTANT CONSIDERATIONS

1. Projected figures shown in both cost of project and means of finance Statements should be realistic.
2. Wherever possible, the projections should be supported by documentary evidences like quotations etc.
3. Since these two statements are extremely important, they should be prepared as precisely as possible.
4. Figures shown in these two statements shall be the basis for preparing other financial statements of the project report.
5. Total of both the statements must tally.

EXERCISE 10 PREPARATION OF STATEMENT OF ANALYTICAL AND COMPARATIVE RATIOS

Structure

- 10.1 Introduction
Objective
- 10.2 Statement of Analytical and Comparative Ratios
Practical Example
- 10.3 Activity
- 10.4 Important Considerations
- 10.5 Answer to Activity

10.1 INTRODUCTION

Ratios signify numerical relationship between two relative figures. Ratio analysis is the process of establishing a significant relationship between the items of financial statements to provide a meaningful understanding of the performance and financial position of a firm. The two figures involved in calculating a particular ratio must have some relationship. Ratio analyses helps in finding out solvency, liquidity and profitability position of a firm.

Objective

After going through this exercise, you should be able to:

- calculate comparative ratios and other related figures.

10.2 STATEMENT OF ANALYTICAL AND COMPARATIVE RATIOS

In presenting a project report to the bankers statement of analytical and comparative ratios plays a vital role. It gives bird's eye-view of the soundness of the Project.

10.2.1 Practical Example

Based on the previous practical exercises following statement has been prepared which contains figures relating to the first two years:

Analytical and Comparative Ratios

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|----------------------|--------|--------|-----|----|---|
| 1. | Net Sales | 106.00 | 127.20 | | | |
| 2. | % rise/fall in sales | ----- | 20.00 | | | |
| 3. | Profit before tax | 8.86 | 11.79 | | | |
| 4. | Net Profit after tax | 7.70 | 9.55 | | | |

| | | | | | | |
|-----|--|-------|-------|--|--|--|
| 5. | A) Equity Dividend declared | 0.00 | 0.00 | | | |
| | B) Equity Dividend paid | 0.00 | 0.00 | | | |
| 6. | Retained Profit | 7.70 | 9.55 | | | |
| 7. | Stock in hand | 12.49 | 14.99 | | | |
| 8. | Month's inventory (in months) | 2.00 | 2.00 | | | |
| 9. | Sundry Debtors | 8.83 | 10.60 | | | |
| 10. | Period of outstanding in months | 1.00 | 1.00 | | | |
| 11. | Sundry Creditors | 3.21 | 3.83 | | | |
| 12. | Net Working Capital | 12.97 | 20.53 | | | |
| 13. | Tangible Net Worth | 18.30 | 27.95 | | | |
| 14. | Total Outside Liabilities | 33.52 | 34.26 | | | |
| 15. | Total Outside Liabilities/TNW | 1.83 | 1.23 | | | |
| 16. | Bank Borrowings/ Total Outside Liability | 0.46 | 0.54 | | | |
| 17. | Net Sales/Total Tangible Net Worth | 5.79 | 4.55 | | | |

Hint: In this statement most of the figures are self explanatory. Certain figures which need explanation are as under:

- % rise/fall in sales:

$$\text{Year II: Rise in sales} = \text{Rs. } 127.20 - 106.00 = 21.20$$

$$\% \text{ rise in sales} = 21.20/106 * 100 = 20\%$$

- *Net Working Capital:* Current Assets - Current Liabilities

$$\text{Year I: (Rs. } 31.73 - 18.76) = \text{Rs. } 12.97 \text{ lacs}$$

- *Tangible Net Worth:* Capital + Reserve and Surplus – Miscellaneous Expenditure

$$\text{Year I: (11.00+7.70-0.40)} = \text{Rs. } 18.30 \text{ lacs}$$

10.3 ACTIVITY

Extending the above Statement of Analytical and Comparative Ratios, calculate figures for the IIIrd, IVth and Vth years.

Analytical and Comparative Ratios

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|--|--------|--------|-------|-------|-------|
| 1. | Net Sales | 106.00 | 127.20 | ----- | ----- | ----- |
| 2. | % rise/fall in sales | ----- | 20.00 | ----- | ----- | ----- |
| 3. | Profit before tax | 8.86 | 11.79 | ----- | ----- | ----- |
| 4. | Net Profit after tax | 7.70 | 9.55 | ----- | ----- | ----- |
| 5. | A) Equity Dividend declared | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | B) Equity Dividend paid | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 6. | Retained Profit | 7.70 | 9.55 | ----- | ----- | ----- |
| 7. | Stock in hand | 12.49 | 14.99 | ----- | ----- | ----- |
| 8. | Month's inventory (in months) | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| 9. | Sundry Debtors | 8.83 | 10.60 | ----- | ----- | ----- |
| 10. | Period of outstanding in months | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| 11. | Sundry Creditors | 3.21 | 3.83 | ----- | ----- | ----- |
| 12. | Net Working Capital | 12.97 | 20.53 | ----- | ----- | ----- |
| 13. | Tangible Net Worth | 18.30 | 27.95 | ----- | ----- | ----- |
| 14. | Total Outside Liabilities | 33.52 | 34.26 | ----- | ----- | ----- |
| 15. | Total Outside Liabilities/TNW | 1.83 | 1.23 | ----- | ----- | ----- |
| 16. | Bank Borrowings/ Total Outside Liability | 0.46 | 0.54 | ----- | ----- | ----- |
| 17. | Net Sales/Total Tangible Net Worth | 5.79 | 4.55 | ----- | ----- | ----- |

Figures for the IIIrd, IVth and Vth years are to be filled in the above Statement after taking the clues given earlier in Hint. Refer point 10.2.

10.4 IMPORTANT CONSIDERATIONS

1. The figures given above are specimen. If the bankers so desire more ratios may be required to be calculated.

2. Two figures chosen for calculating any ratio must have some relationship. They should not be abstract figures.
3. Figures may be taken either from profitability statement or balance sheet or combination of both.

10.5 ANSWER TO ACTIVITY

Analytical and Comparative Ratios

| Sl. No. | Particulars | I | II | III | IV | V |
|----------------|--|----------|-----------|------------|-----------|----------|
| 1. | Net Sales | 106.00 | 127.20 | 148.40 | 169.60 | 169.60 |
| 2. | % rise/fall in sales | ----- | 20.00 | 16.67 | 14.29 | 0.00 |
| 3. | Profit before tax | 8.86 | 11.79 | 14.72 | 17.64 | 17.86 |
| 4. | Net Profit after tax | 7.70 | 9.55 | 11.47 | 13.45 | 13.48 |
| 5. | A) Equity Dividend declared | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | B) Equity Dividend paid | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 6. | Retained Profit | 7.70 | 9.55 | 11.47 | 13.45 | 13.48 |
| 7. | Stock in hand | 12.49 | 14.99 | 17.49 | 19.98 | 19.98 |
| 8. | Month's inventory (in months) | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 |
| 9. | Sundry Debtors | 8.83 | 10.60 | 12.37 | 14.13 | 14.13 |
| 10. | Period of outstanding in months | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| 11. | Sundry Creditors | 3.21 | 3.83 | 4.46 | 5.09 | 5.10 |
| 12. | Net Working Capital | 12.97 | 20.53 | 30.01 | 41.47 | 52.97 |
| 13. | Tangible Net Worth | 18.30 | 27.95 | 39.52 | 53.08 | 66.66 |
| 14. | Total Outside Liabilities | 33.52 | 34.26 | 35.00 | 35.73 | 32.74 |
| 15. | Total Outside Liabilities/TNW | 1.83 | 1.23 | 0.89 | 0.67 | 0.49 |
| 16. | Bank Borrowings/ Total Outside Liability | 0.46 | 0.54 | 0.62 | 0.70 | 0.76 |
| 17. | Net Sales/Total Tangible Net Worth | 5.79 | 4.55 | 3.75 | 3.20 | 2.54 |

EXERCISE 2 PREPARATION OF DEPRECIATION SCHEDULE

Structure

- 2.1 Introduction
 - Objective
- 2.2 Depreciation Schedule
 - Straight Line Method (SLM)
 - Written Down Value Method (WDV)
- 2.3 Activity
 - Depreciation Schedule (SLM)
 - Depreciation Schedule (WDV – for Income Tax purpose)
- 2.4 Important Considerations
- 2.5 Answer to Activity

2.1 INTRODUCTION

In any project, fixed assets are used which give benefits for more than one year. We categorise fixed assets under land and buildings, plant and machinery, miscellaneous fixed assets (i.e. furniture and fixtures, office equipment) etc. In case, the cost of these assets is charged to profit & loss account in the first year itself, there shall be heavy losses. To avoid this, a particular portion of the purchase cost is treated as depreciation and charged to the current year's profit. It may be noted that the value of fixed assets reduces year by year due to physical wear and tear, passage of time and obsolescence. This results in depreciation of fixed assets. Therefore, an allowance for depreciation must be made in the books of accounts.

Objective

After going through this exercise, you should be able to:

- calculate depreciation by using different methods.

2.2 DEPRECIATION SCHEDULE

For preparing depreciation schedule we should know the methods of calculating depreciation. Two most popular methods duly recognised for charging depreciation are:

1. Straight Line Method (SLM)
2. Written Down Value method (WDV)

Let us describe these methods before preparing the depreciation schedule:

2.2.1 Straight Line Method (SLM)

SLM method of charging depreciation is quite popular and simple to calculate. Under this method a fixed percentage is charged on the original cost of the asset every year. The amount of depreciation remains same each year. To find the depreciation rate per annum following formula may be used:

Rate of Depreciation = 100/Useful life of asset.

For example, an asset is expected to give benefits for 10 years i.e. its useful life is 10 years. Applying the above formula the rate of depreciation is 10% which should be applied to the original cost of asset. Scrap value, if any which the asset is expected to realise at the end of the useful life should be deducted from the original cost, before applying the rate of depreciation.

Preparation of Depreciation Schedule (SLM)

We may refer Practical Exercise 1. From cost of project statement, we notice that cost of plant and machinery is Rs. 20.00 lacs. Adding contingencies of Rs. 1.00 lac to this figure the total becomes Rs. 21.00 lacs. This is the original cost of asset on which depreciation is to be charged at the given rate of 4.33% p.a. Depreciation Schedule for the Year I is given as under:

Depreciation Schedule (SLM)

| S.No. | Particulars | I | II | III | IV | V |
|-------|--|--------------|----|-----|----|---|
| | | (Rs. in Lac) | | | | |
| 1. | Plant & Machinery/ Other Fixed Assets | | | | | |
| | Opening | 20.00 | | | | |
| | Add: Contingencies | 1.00 | | | | |
| | Sub Total | 21.00 | | | | |
| | Depreciation | 0.91 | | | | |
| | Closing | 20.09 | | | | |
| 2. | Total Opening Fixed Asset (FA) | 21.00 | | | | |
| 3. | Total Depreciation | 0.91 | | | | |
| 4. | Total Closing Fixed Asset (FA) | 20.09 | | | | |

2.2.2 Written Down Value Method (WDV)

Under WDV method (also known as Diminishing Balance Method) depreciation is charged at a fixed rate on the reduced value of the asset. In the Ist year the depreciation is charged on the original cost of the asset. In the IInd year, the original cost is reduced by the amount of depreciation. This reduced cost, known as written down value, is used for applying the fixed rate of depreciation. This system is followed in the subsequent years also till the useful life of the asset. For the purpose of Income Tax, WDV method of calculating depreciation is acceptable.

Preparation of Depreciation Schedule (WDV – for Income Tax purpose)

We may refer Practical Exercise 1. As already noticed, the original cost of plant and machinery/MFA after adding the amount of contingencies is Rs.21.00 lacs. On this original cost we have to charge depreciation at the given rate of 25% p.a. Depreciation Schedule for the Year I is given as under:

Depreciation Schedule (WDV – for Income Tax purpose)

| S.No. | Particulars | I | II | III | IV | V |
|-------|-----------------------------------|-------|----|-----|----|---|
| 1. | Plant & Machinery/ MFA | | | | | |
| | Opening | 20.00 | | | | |
| | Add: Contingencies | 1.00 | | | | |
| | Sub Total | 21.00 | | | | |
| | Depreciation | 5.25 | | | | |
| | Closing | 15.75 | | | | |
| 2. | Total Opening Fixed Asset (FA) | 21.00 | | | | |
| 3. | Total Depreciation | 5.25 | | | | |
| 4. | Total Closing Fixed Asset (FA) | 15.75 | | | | |

2.3 ACTIVITY

Let us now complete the following activities:

2.3.1 Depreciation Schedule (SLM)

On the basis of Depreciation Schedule (SLM) given above for the first year, calculate figures of depreciation for the next four years. The rate of depreciation is same as was used in the first year i.e. 4.33% p.a.

Depreciation Schedule (SLM)

| S.No. | Particulars | I | II | III | IV | V |
|-------|--|-------|------|-------|-------|-------|
| 1. | Plant & Machinery/ Other Fixed Assets | | | | | |
| | Opening | 20.00 | ---- | ----- | ----- | ----- |
| | Add: Contingencies | 1.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Sub Total | 21.00 | ---- | ----- | ----- | ----- |
| | Depreciation | 0.91 | ---- | ----- | ----- | ----- |
| | Closing | 20.09 | ---- | ----- | ----- | ----- |
| 2. | Total Opening Fixed Asset (FA) | 21.00 | ---- | ----- | ----- | ----- |
| 3. | Total Depreciation | 0.91 | ---- | ----- | ----- | ----- |
| 4. | Total Closing Fixed Asset (FA) | 20.09 | ---- | ----- | ----- | ----- |

(Hint: In the IInd year also, the amount of depreciation remains same at Rs.0.91 lacs. The closing balance of fixed assets (i.e. Rs.20.09 lacs) becomes opening balance in the IInd year. Out of this figure deduct Rs.0.91 lacs to get the closing balance of fixed assets in the IInd year.) Same procedure is to be followed in the subsequent years.

2.3.2 Depreciation Schedule (WDV – for Income Tax purpose)

On the basis of Depreciation Schedule (WDV – for Income Tax purpose) given above for the first year, calculate figures of depreciation for the next four years. The rate of depreciation is same as was used in the first year i.e. 25% p.a.

Depreciation Schedule (WDV – for Income Tax purpose)

| S.No. | Particulars | I | II | III | IV | V |
|-------|--|-------|------|-------|-------|-------|
| 1. | Plant & Machinery/ Other Fixed Assets | | | | | |
| | Opening | 20.00 | ---- | ----- | ----- | ----- |
| | Add: Contingencies | 1.00 | ---- | ----- | ----- | ----- |
| | Sub Total | 21.00 | ---- | ----- | ----- | ----- |
| | Depreciation | 5.25 | ---- | ----- | ----- | ----- |
| | Closing | 15.75 | ---- | ----- | ----- | ----- |
| 2. | Total Opening Fixed Asset (FA) | 21.00 | ---- | ----- | ----- | ----- |
| 3. | Total Depreciation | 5.25 | ---- | ----- | ----- | ----- |
| 4. | Total Closing Fixed Asset (FA) | 15.75 | ---- | ----- | ----- | ----- |

(Hint: In the IInd year, the Balance i.e. written down value (WDV) of Plant and Machinery (P&M) after charging depreciation of Rs.5.25 lacs is Rs.15.75 lacs. WDV of Rs.15.75 lacs becomes the base for calculating depreciation on P&M @ 25% in the IInd year. The depreciation works out to Rs.3.94 lacs. This system is followed in the subsequent years also. Under WDV method the depreciation amount decreases year by year.

2.4 IMPORTANT CONSIDERATIONS

1. The rate of depreciation to be applied on the cost of fixed assets must be selected with due care keeping in view the legal requirements.
2. Depreciation for 'profitability statement' may be charged as per SLM method but for the purpose of income tax depreciation must be charged according to WDV method.
3. Depreciation should be charged in respect of all types of fixed assets given in the Cost of Project Statement.

2.5 ANSWER TO ACTIVITY

Depreciation Schedule (SLM)

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|--------------------------------------|-------|-------|-------|-------|-------|
| 1. | Plant & Machinery/Other Fixed Assets | | | | | |
| | Opening | 20.00 | 20.09 | 19.18 | 18.27 | 17.36 |
| | Add: Contingencies | 1.00 | | | | |
| | Sub Total | 21.00 | 20.09 | 19.18 | 18.27 | 17.36 |
| | Depreciation | 0.91 | 0.91 | 0.91 | 0.91 | 0.91 |
| | Closing | 20.09 | 19.18 | 18.27 | 17.36 | 16.45 |
| 2. | Total Opening Fixed Asset | 21.00 | 20.09 | 19.18 | 18.27 | 17.36 |
| 3. | Total Depreciation | 0.91 | 0.91 | 0.91 | 0.91 | 0.91 |
| 4. | Total Closing Fixed Asset | 20.09 | 19.18 | 18.27 | 17.36 | 16.45 |

Depreciation Schedule (WDV – for Income Tax purpose)

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|---------------------------|-------|-------|-------|------|------|
| 1. | Plant & Machinery/MFA | | | | | |
| | Opening | 20.00 | 15.75 | 11.81 | 8.86 | 6.64 |
| | Add : Contingencies | 1.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | Sub Total | 21.00 | 15.75 | 11.81 | 8.86 | 6.64 |
| | Depreciation | 5.25 | 3.94 | 2.95 | 2.21 | 1.66 |
| | Closing | 15.75 | 11.81 | 8.86 | 6.64 | 4.98 |
| 2. | Total Opening Fixed Asset | 21.00 | 15.75 | 11.81 | 8.86 | 6.64 |
| 3. | Total Depreciation | 5.25 | 3.94 | 2.95 | 2.21 | 1.66 |
| 4. | Total Closing Fixed Asset | 15.75 | 11.81 | 8.86 | 6.64 | 4.98 |

EXERCISE 3 PREPARATION OF STATEMENT OF PRODUCTION, RAW MATERIAL CONSUMED AND GROSS SALES

Structure

- 3.1 Introduction
 - Objective
- 3.2 Statement of Production, Raw Material Consumed and Gross Sales
 - Practical Exercise
 - Assumptions
- 3.3 Activity
- 3.4 Important Considerations
- 3.5 Answer to Activity

3.1 INTRODUCTION

For preparing a project report we need to know installed and average capacity utilisation, figures of production, raw material consumed, gross sales etc. If these figures are known with precision, future projections regarding investment proposal can be quite authentic. For this purpose we prepare statement of production, raw material consumed, and gross sales. This statement helps in preparing other financial reports relating to the project.

Objective

After going through this exercise, you should be able to:

- prepare the statement of production, raw material consumed and gross sales.

3.2 STATEMENT OF PRODUCTION, RAW MATERIAL CONSUMED AND GROSS SALES

As already stated this statement is prepared to calculate total cost of raw material consumed and total sales. Following format (indicating projections for five years) may be used to prepare such a Statement:

Format of Statement of Production, Raw Material Consumed and Gross Sales

| S.No. | Particulars | I | II | III | IV | V |
|-------|--|---|----|-----|----|---|
| 1. | Installed Capacity in KG per annum | | | | | |
| 2. | No. of working days per annum | | | | | |
| 3. | Average Capacity Utilisation | | | | | |
| 4. | Projected Production in KG p.a. | | | | | |
| 5. | Raw Material required in KG | | | | | |
| 6. | Cost of Raw Material per KG in Rs. | | | | | |
| 7. | Total Cost of Raw Material Consumed (Rs. in lacs) | | | | | |
| 8. | Selling price per KG in Rs. | | | | | |
| 9. | Total Sales (Rs. in lacs) | | | | | |

3.2.1 Practical Example

Let us now have a look at the practical example. Before attempting to prepare the statement, we should know the assumptions based on which the statement shall be prepared.

3.2.2 Assumptions

Following assumptions are to be used for preparing the statement:

- *Installed capacity of the plant Purchased* : to produce 2,00,000 kgs. of food item M in a year.
- *Number of working days in a year* : 300 days.
- *Capacity utilisation in the first year* : 50% of the installed capacity.
- *Capacity utilisation in the subsequent years* : 60% (IInd year), 70% (IIIrd year; and 80% (IVth and subsequent years).

Note: Maximum capacity utilisation will be 80% of the installed capacity.

- Consumption of raw material : Actual consumption + 1% for wastage.
- Cost of raw material : Rs. 53 per Kg.
- Selling price of the food item M : Rs. 106 per Kg.

Based on the above assumptions, statement of production, raw material consumed, and gross sales has been prepared as under. In this statement projections for first year only have been calculated.

Statement of Production, Raw Material Consumed and Gross Sales

Preparation of
Statement of
Production, Raw
Material
Consumed and
Gross Sales

| S. No. | Particulars | I |
|--------|--|----------|
| 1. | Installed Capacity in KG per annum | 2,00,000 |
| 2. | No. of working days per annum | 300 |
| 3. | Average Capacity Utilisation | 50 |
| 4. | Projected Production in KG p.a. | 1,00,000 |
| 5. | Raw Material required in KG (with 1% wastage) | 1,01,000 |
| 6. | Cost of Raw Material per KG in Rs. | 53 |
| 7. | Total Cost of Raw Material Consumed (Rs. in lacs) | 53.53 |
| 8. | Selling price per KG in Rs. | 106 |
| 9. | Total Sales (Rs. in lacs) | 106.00 |

3.3 ACTIVITY

On the basis of statement given above for the first year, calculate projections for the next four years. Assumptions given above are to be used in preparing the statement.

Statement of Production, Raw Material Consumed and Gross Sales

| S. No. | Particulars | I | II | III | IV | V |
|--------|--|----------|------|------|------|------|
| 1. | Installed Capacity in KG per annum | 2,00,000 | ---- | ---- | ---- | ---- |
| 2. | No. of working days per annum | 300 | ---- | ---- | ---- | ---- |
| 3. | Average Capacity Utilisation | 50 | ---- | ---- | ---- | ---- |
| 4. | Projected Production in KG p.a. | 1,00,000 | ---- | ---- | ---- | ---- |
| 5. | Raw Material required in KG | 1,01,000 | ---- | ---- | ---- | ---- |
| 6. | Cost of Raw Material per KG in Rs. | 53 | ---- | ---- | ---- | ---- |
| 7. | Total Cost of Raw Material Consumed (Rs. in lacs) | 53.53 | ---- | ---- | ---- | ---- |
| 8. | Selling price per KG in Rs. | 106 | ---- | ---- | ---- | ---- |
| 9. | Total Sales (Rs. in lacs) | 106.00 | ---- | ---- | ---- | ---- |

3.4 IMPORTANT CONSIDERATIONS

1. The assumptions used in the first year are to be used in the subsequent years.
2. Keeping in view the product to be manufactured, the assumptions should be made.

3. Installed capacity of the plant may be obtained from the quotation given by the supplier of the plant.
4. Utilisation of the installed capacity in the first and subsequent years should be quite realistic. It may be noted that under no circumstances 100% utilisation of the installed capacity can be achieved. Therefore, assumption of 100% utilisation shall be an invalid assumption.
5. Cost of raw material and selling price of the manufactured product should be based on market survey.

3.5 ANSWER TO ACTIVITY

Statement of Production, Raw Material Consumed, Gross Sales

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|---|--------|--------|--------|--------|--------|
| 1. | Installed Capacity in KG per annum | 200000 | 200000 | 200000 | 200000 | 200000 |
| 2. | No. of working days per annum | 300 | 300 | 300 | 300 | 300 |
| 3. | Average Capacity Utilisation | 50 | 60 | 70 | 80 | 80 |
| 4. | Projected Production in KG p.a. | 100000 | 120000 | 140000 | 160000 | 160000 |
| 5. | Raw Material required in KG (With 1% wastage) | 101000 | 121200 | 141400 | 161600 | 161600 |
| 6. | Cost of Raw Material per KG in Rs. | 53 | 53 | 53 | 53 | 53 |
| 7. | Total Cost of Raw Material Consumed (Rs. in lacs) | 53.53 | 64.24 | 74.94 | 85.65 | 85.65 |
| 8. | Selling price per KG in Rs. | 106 | 106 | 106 | 106 | 106 |
| 9. | Total Sales (Rs. In lacs) | 106.00 | 127.20 | 148.40 | 169.60 | 169.60 |

EXERCISE 4 CALCULATIONS OF WORKING CAPITAL

Structure

- 4.1 Introduction
 - Objective
- 4.2 Calculation of Working Capital
 - Practical Example
- 4.3 Activity
- 4.4 Important Considerations
- 4.5 Answer to Activity

4.1 INTRODUCTION

Working capital is the amount used by a business unit to meet out its daily requirements. It is also known as circulatory capital. The amount spent on payment of wages, salaries, stock purchased, raw material purchased, cartage etc. are all examples of working capital.

Objective

After going through this exercise, you should be able to:

- calculate working capital.

4.2 CALCULATION OF WORKING CAPITAL

For calculating working capital, we have to use other Practical Exercises, reference of which has been given against the item concerned. Working capital for the Ist year has been calculated as under:

- 1. i) Raw Material (Rs. in lacs) 53.53 (refer Practical Exercise 3)
- ii) Packing Material (Rs. in lacs) 21.41 (40% of cost of raw material)

| | |
|--------------|-------|
| | ===== |
| Total | 74.94 |
| | ===== |

- Requirement for 2 months = $74.94 \times 2/12 = 12.49$
 - Margin Money (to be brought in by the borrower) $12.49 \times 25\% = 3.12$
2. Debtors:

It is assumed that debtors are equal to one months' gross sales i.e. $106/12 = 8.83$ (for gross sales refer Practical Exercise 3)

Margin Money (to be brought in by the borrower) $8.83 \times 30\% = 2.65$

| | | |
|----------------|--------------|-------------------------------|
| 3. Others | | |
| Salary & Wages | 13.38 | (25% of cost of raw material) |
| Power and Fuel | 2.46 | (refer Practical Exercise 9) |
| Gen Adm. | 2.00 | (refer Practical Exercise 5) |
| | ===== | |
| Total | 17.84 | |
| | ===== | |

Requirement for 1 month = $17.84/12 = 1.49$

Note: In this case the borrower has to bring working capital of Rs. 1.49 at his own. Therefore, the margin money is 100%.

Total Working Capital

| | |
|------------------------------------|--------------|
| 1. Raw Material & Packing Material | 12.49 |
| 2. Debtors | 8.83 |
| 3. Others | 1.49 |
| | ===== |
| Total | 22.81 |
| | ===== |

- Total Margin Money $(3.12 + 2.65 + 1.49) = 7.26$
- Bank Borrowings for WC $(22.81 - 7.26) = 15.55$
- Interest on Bank Borrowings for WC has been calculated @ 11.50%

4.2.1 Practical Example

Based on the above calculations working capital calculations for the 1st year are shown in the following Statement:

Statement of Working Capital Calculation

| Cost of Elements | Margin (%) | Months of Inventory | Margin Money | Amount |
|--|------------|---------------------|--------------|--------------|
| | | | | YEAR I |
| A. TOTAL CURRENT ASSETS: | | | | |
| 1) Raw materials, consumables and packing material | 25 | 2.00 | 3.12 | 12.49 |
| 2) Debtors | 30 | 1.00 | 2.65 | 8.83 |
| 3) Others | | | | |
| Salary & Wages | 100 | 1.00 | 1.12 | 1.12 |
| Power & Fuel | 100 | 1.00 | 0.21 | 0.21 |
| General Administration | 100 | 1.00 | 0.17 | 0.17 |
| Total | | | 7.26 | 22.81 |
| B. WORKING CAPITAL | | | | 7.26 |
| C. BANK BORROWINGS FOR WC | | | | 15.55 |
| D. INTEREST ON BANK BORROWINGS | | 11.50% | | 1.79 |

4.3 ACTIVITY

On the basis of working capital calculations given above for the first year, calculate projections for the next four years. Assumptions given above are to be used in calculating the working capital for the subsequent years.

Statement of Working Capital Calculation

| Cost of Elements | Margin (%) | Months of inventory | Margin money | Amount Year I | Amount Year II | Amount Year III | Amount Year IV |
|--|------------|---------------------|--------------|---------------|----------------|-----------------|----------------|
| A. TOTAL CURRENT ASSETS : | | | | | | | |
| 1) Raw materials, consumables and packing material | 25 | 2.00 | 3.12 | 12.49 | ----- | ----- | ----- |
| 2) Debtors | 30 | 1.00 | 2.65 | 8.83 | ----- | ----- | ----- |
| 3) Others | | | | | | | |
| Salary & Wages | 100 | 1.00 | 1.12 | 1.12 | ----- | ----- | ----- |
| Power & Fuel | 100 | 1.00 | 0.21 | 0.21 | ----- | ----- | ----- |
| General Admn. | 100 | 1.00 | 0.17 | 0.17 | ----- | ----- | ----- |
| Total | | | 7.26 | 22.81 | ----- | ----- | ----- |
| B. WORKING CAPITAL | | | | 7.26 | ----- | ----- | ----- |
| C. BANK BORROWINGS FOR WC | | | | 15.55 | ----- | ----- | ----- |
| D. INTEREST ON BANK BORROWINGS | | 11.50% | | 1.79 | ----- | ----- | ----- |

4.4 IMPORTANT CONSIDERATIONS

1. A particular level of current assets (i.e. working capital) is financed by the commercial banks. Assumptions regarding calculation of working capital, margin money to be brought in should be quite realistic.
2. Working capital is the difference between current assets and current liabilities. In this Project Report current liabilities on account of trade creditors, bills payable etc. have not been considered. It is so because in the initial stages supply of raw material etc. may not be on credit and the promoters may be required to make cash payments. Therefore, current assets are considered as working capital.
3. Interest on working loan is assumed to be 11.50%. The correct rate of interest must be ascertained from banks at the time of preparing Project Report.
4. There may be certain expenses (like salary & wages, power and fuel etc.) for which bank finance is not available. These expenses are to be met by the promoter from his own resources.

4.5 ANSWER TO ACTIVITY

| Cost of Elements | Margin (%) | Months of inventory | Margin money | Amount Year I | Amount Year II | Amount Year III | Amount Year IV |
|--|------------|---------------------|--------------|---------------|----------------|-----------------|----------------|
| <i>A. TOTAL CURRENT ASSETS :</i> | | | | | | | |
| 1) Raw materials, consumables and packing material | 25 | 2.00 | 3.12 | 12.49 | 14.99 | 17.49 | 19.98 |
| 2) Debtors | 30 | 1.00 | 2.65 | 8.83 | 10.60 | 12.37 | 14.13 |
| 3) Others | | | | | | | |
| Salary & Wages | 100 | 1.00 | 1.12 | 1.12 | 1.34 | 1.56 | 1.78 |
| Power & Fuel | 100 | 1.00 | 0.21 | 0.21 | 0.25 | 0.29 | 0.33 |
| General Admn. | 100 | 1.00 | 0.17 | 0.17 | 0.18 | 0.18 | 0.19 |
| Total | | | 7.26 | 22.81 | 27.35 | 31.89 | 36.42 |
| <i>B. WORKING CAPITAL</i> | | | | 7.26 | 8.69 | 10.11 | 11.54 |
| <i>C. BANK BORROWINGS FOR WC</i> | | | | 15.55 | 18.66 | 21.77 | 24.88 |
| <i>D. INTEREST ON BANK BORROWINGS</i> | | 11.50% | | 1.79 | 2.15 | 2.50 | 2.86 |

EXERCISE 5 PREPARATION OF PROFITABILITY STATEMENT

Structure

- 5.1 Introduction
 - Objective
- 5.2 Profitability Statement
 - Practical Example
 - Assumptions
- 5.3 Activity
- 5.4 Important Considerations
- 5.5 Answer to Activity

5.1 INTRODUCTION

Profit is the parameter through which efficiency of a business unit is judged. It enables the businessman to measure his performance against the standards set. Profit is a guiding factor as businessman improves his performance by minimizing his expenses and improving his turnover. Profit also helps the investors, bankers, creditors etc. to form a positive opinion about the business unit. Profit is calculated by making a profitability statement.

Objective

After going through this exercise, you should be able to:

- understand the procedure of making a profitability statement.

5.2 PROFITABILITY STATEMENT

In a project report, profitability statement plays a vital role. It gives the figures of profit which a project is expected to earn from year to year. Following format (indicating projections for five years) may be used for preparing profitability statement:

Format of Profitability Statement

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|---------------------------|---|----|-----|----|---|
| I. | Income | | | | | |
| | Gross Sales (Rs. in lacs) | | | | | |
| | Total Income | | | | | |
| II. | Expenditure | | | | | |
| | Cost of Raw Material | | | | | |
| | Packing Material | | | | | |
| | Salary & Wages | | | | | |

| | | | | | | |
|--------------------------|--|--|--|--|--|--|
| | Power & Fuel | | | | | |
| | General Administration | | | | | |
| | Interest on Term Loan | | | | | |
| | Interest on WC Loan | | | | | |
| | Depreciation | | | | | |
| | Preliminary Expenses W/O | | | | | |
| | Total Expenditure | | | | | |
| III. | Operating Profit (I–II) | | | | | |
| IV. | Interest on Investment | | | | | |
| V. | Profit before Tax (III+IV) | | | | | |
| VI. | Taxation (As per Statement IX) | | | | | |
| VII. | Net Profit (V–VI) | | | | | |
| VIII. | Dividend | | | | | |
| IX. | Net Profit C/F to B/S | | | | | |
| X. | Cash Accruals (NP + Dep. + P.Exps.) | | | | | |
| 1. Debt service /Year | | | | | | |
| 2. Fund for Debt Service | | | | | | |
| 3. DSCR (2/1) | | | | | | |

5.2.1 Practical Example

Let us now have a look at the practical example. Before attempting to prepare the profitability statement, we should know the assumptions based on which the profitability statement shall be prepared.

5.2.2 Assumptions

Following assumptions have been used for preparing the profitability statement:

- *Gross sales and cost of raw material:* To be obtained from statement of production, raw material consumed and gross sales (refer Practical Exercise 3).
- Other expenses have been assumed to be as under:
 - *Packing material:* 40% of cost of raw material.
 - *Salary and wages:* 25% of cost of raw material.
 - *Power & fuel:* (refer Practical Exercise 9).
 - *General administration:* Rs.2.00 lac in the first year. Thereafter, to be increased by 5% in the subsequent years.
 - *Interest on term loan:* 11.5% p.a. (to be applied on the average of opening and closing balance in each year).

- *Interest on working capital (WC) loan:* 11.5% p.a. (refer Practical Exercise 4).
- *Depreciation* (as calculated earlier - refer Practical Exercise 2).
- *Preliminary expenses to be w/off:* One-fifth of total preliminary expenses of Rs.0.50 lacs (i.e. Rs.0.10 lacs) to be written off in each year.

Based on the above assumptions, profitability statement has been prepared as under. In this statement projections for first year only have been calculated.

Profitability Statement

| Sl. No. | Particulars | I |
|---------|--------------------------------------|---------------|
| I. | Income | |
| | Gross Sales (Rs. in lacs) | 106.00 |
| | Total Income | 106.00 |
| II. | Expenditure | |
| | Cost of Raw Material | 53.53 |
| | Packing Material | 21.41 |
| | Salary & Wages | 13.38 |
| | Power & Fuel | 2.46 |
| | General Administration | 2.00 |
| | Interest on Term Loan | 1.55 |
| | Interest on WC Loan | 1.79 |
| | Depreciation | 0.91 |
| | Preliminary Expenses W/O | 0.10 |
| | Total Expenditure | 97.14 |
| III. | Operating Profit (I–II) | 8.86 |
| IV. | Interest on Investment | 0.00 |
| V. | Profit before Tax (III+IV) | 8.86 |
| VI. | Taxation (As per Statement IX) | 1.16 |
| VII. | Net Profit (V–VI) | 7.70 |
| VIII. | Dividend | 0.00 |
| IX. | Net Profit C/F to B/S | 7.70 |
| X. | Cash Accruals (NP + Dep. + P. Exps.) | 8.71 |
| 1. | Debt Service /Year | 4.55 |
| 2. | Fund for Debt Service | 10.27 |
| 3. | DSCR (2/1) | 2.26 |

5.3 ACTIVITY

On the basis of profitability statement given above for the first year, calculate projections for the next four years. Assumptions given above are to be used in preparing the profitability statement for the subsequent years.

Profitability Statement

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|---|---------------|------|------|------|------|
| I. | Income | | | | | |
| | Gross Sales (Rs. in lacs) | 106.00 | ---- | ---- | ---- | ---- |
| | Total Income | 106.00 | ---- | ---- | ---- | ---- |
| II. | Expenditure | | | | | |
| | Cost of Raw Material | 53.53 | ---- | ---- | ---- | ---- |
| | Packing Material | 21.41 | ---- | ---- | ---- | ---- |
| | Salary & Wages | 13.38 | ---- | ---- | ---- | ---- |
| | Power & Fuel | 2.46 | ---- | ---- | ---- | ---- |
| | General Administration | 2.00 | ---- | ---- | ---- | ---- |
| | Interest on Term Loan | 1.55 | ---- | ---- | ---- | ---- |
| | Interest on WC Loan | 1.79 | ---- | ---- | ---- | ---- |
| | Depreciation | 0.91 | ---- | ---- | ---- | ---- |
| | Preliminary Expenses W/O | 0.10 | ---- | ---- | ---- | ---- |
| | Total Expenditure | 97.14 | ---- | ---- | ---- | ---- |
| III. | Operating Profit (I–II) | 8.86 | ---- | ---- | ---- | ---- |
| IV. | Interest on Investment | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| V. | Profit before Tax (III+IV) | 8.86 | ---- | ---- | ---- | ---- |
| VI. | Taxation (As per Statement IX) | 1.16 | ---- | ---- | ---- | ---- |
| VII. | Net Profit (V–VI) | 7.70 | ---- | ---- | ---- | ---- |
| VIII. | Dividend | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| IX. | Net Profit C/F to B/S | 7.70 | ---- | ---- | ---- | ---- |
| X. | Cash Accruals (NP + Dep. + P. Exps.) | 8.71 | ---- | ---- | ---- | ---- |
| 1. | Debt Service /Year | 4.55 | ---- | ---- | ---- | ---- |
| 2. | Fund for Debt Service | 10.27 | ---- | ---- | ---- | ---- |
| 3. | DSCR (2/1) | 2.26 | ---- | ---- | ---- | ---- |

5.4 IMPORTANT CONSIDERATIONS

1. Keeping in view the product to be manufactured, the assumptions for preparing profitability statement should be quite realistic.
2. Expenses should not be understated. If understated, the profitability shall be overstated resulting in unreliability of projections.
3. Following equations may be used for calculating profits:
 - Operating profit = Operating Income – Operating Expenditure
 - Profit before Tax = Operating profit + Non-operating Income
 - Net Profit after Tax = Profit before Tax – Income Tax
4. Following equations may be used for calculating:
 - *Debt Service per Year*: Yearly instalment of term loan + Interest on term loan; and
 - *Funds for Debt Service*: Net Profit + Interest on term loan + Depreciation + Preliminary Expenses W/off.
5. Cash accruals are calculated by adjusting net profit in the light of non-cash items like depreciation and preliminary expenses written off.

5.5 ANSWER TO ACTIVITY

Profitability Statement

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|------------------------------|---------------|---------------|---------------|---------------|---------------|
| I. | Income | | | | | |
| | Gross Sales (Rs. in lacs) | 106.00 | 127.20 | 148.40 | 169.60 | 169.60 |
| | Total Income | 106.00 | 127.20 | 148.40 | 169.60 | 169.60 |
| II. | Expenditure | | | | | |
| | Cost of Raw Material | 53.53 | 64.24 | 74.94 | 85.65 | 85.65 |
| | Packing Material | 21.41 | 25.69 | 29.98 | 34.26 | 34.26 |
| | Salary & Wages | 13.38 | 16.06 | 18.74 | 21.41 | 21.41 |
| | Power & Fuel | 2.46 | 2.96 | 3.45 | 3.94 | 3.94 |
| | General Admn. | 2.00 | 2.10 | 2.21 | 2.32 | 2.43 |
| | Interest on Term Loan | 1.55 | 1.21 | 0.86 | 0.52 | 0.17 |
| | Interest on WC Loan | 1.79 | 2.15 | 2.50 | 2.86 | 2.86 |
| | Depreciation | 0.91 | 0.91 | 0.91 | 0.91 | 0.91 |
| | Preliminary Expenses W/O | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| | Total Expenditure | 97.14 | 115.41 | 133.68 | 151.96 | 151.74 |

| | | | | | | |
|-------|---|-------|-------|-------|-------|-------|
| III. | Operating Profit (I–II) | 8.86 | 11.79 | 14.72 | 17.64 | 17.86 |
| IV. | Interest on Investment | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| V. | Profit before Tax (III+IV) | 8.86 | 11.79 | 14.72 | 17.64 | 17.86 |
| VI. | Taxation (As per Statement IX) | 1.16 | 2.24 | 3.24 | 4.18 | 4.38 |
| VII. | Net Profit (V–VI) | 7.70 | 9.55 | 11.47 | 13.45 | 13.48 |
| VIII. | Dividend | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| IX. | Net Profit C/F to B/S | 7.70 | 9.55 | 11.47 | 13.45 | 13.48 |
| X. | Cash Accruals (NP + Dep. + P. Exps.) | 8.71 | 10.56 | 12.48 | 14.46 | 14.49 |
| 1. | Debt Service /Year | 4.55 | 4.21 | 3.86 | 3.52 | 3.17 |
| 2. | Fund for Debt Service | 10.27 | 11.76 | 13.34 | 14.98 | 14.67 |
| 3. | DSCR (2/1) | 2.26 | 2.80 | 3.45 | 4.26 | 4.62 |

EXERCISE 6 PREPARATION OF TAXATION STATEMENT

Structure

- 6.1 Introduction
 - Objective
- 6.2 Taxation Statement
 - Practical Example
- 6.3 Activity
- 6.4 Important Considerations
- 6.5 Answer to Activity

6.1 INTRODUCTION

Income tax is paid on the income earned during the financial year. For this purpose net profit as obtained from the profitability statement becomes the base for calculating income tax. However, figure of net profit as shown by the profitability statement is to be adjusted in the light of depreciation charged and depreciation which ought to be charged as per income tax provisions. There may be certain other adjustments which need to be made before calculating tax payable. Some deductions from the income chargeable to tax might also be available. In other words, net profit must be adjusted before calculating correct figure of tax. For this purpose we prepare taxation statement.

Objective

After going through this exercise, you should be able to:

- calculate income tax chargeable.

6.2 TAXATION STATEMENT

As already stated this statement is prepared for the purpose of calculating income tax. All the adjustments required to be made to arrive at the correct taxable amount of profit must be made.

6.2.1 Practical Example

Let us now have a look at the practical example. In the following taxation statement figures for the 1st year have been calculated.

In this Statement 'Net Profit before Tax' has been adjusted by adding depreciation (SLM) (refer Practical Exercise 2) and deducting from the total so obtained, 'depreciation allowable as per Income Tax Act (refer Practical Exercise 2). While calculating income tax, it is assumed that deduction under Section 80IB of the Income Tax Act is available. Accordingly, an adjustment on this account has been made. Thereafter, income tax has been calculated as per the following rates:

- Rate of Income Tax : 35%
- Surcharge : 2.5% of income tax amount
- Education Cess : 2% of income tax amount and surcharge

Calculations

| | | |
|--|---|---|
| Taxable Profit | : | 3.16 lacs |
| Income tax @ 35% | : | $3.16 \times 35 / 100 = 1.106$ lacs |
| Surcharge @ 2.5% | : | $(1.106 \times 2.5 / 100) = 0.0277$ |
| Education Cess | : | $(1.106 + 0.0277) \times 2 / 100 = 0.0227$ |
| Income tax + Surcharge + Education Cess | : | $(1.106 + 0.0277 + 0.0227) = 1.1564$ or Rs.1.16 lacs. |

Taxation Statement

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|--|------|----|-----|----|---|
| A. | Net Profit Before Tax (refer Practical Exercise 5) | 8.86 | | | | |
| B. | Add Depreciation as per Project (refer Practical Exercise 2) | 0.91 | | | | |
| C. | Less Depreciation as per Income Tax (refer Practical Exercise 2) | 5.25 | | | | |
| D. | Subtotal (A+B-C) | 4.52 | | | | |
| E. | Less Unabsorbed Losses of Earlier Years | | | | | |
| F. | Subtotal | 4.52 | | | | |
| G. | Deduction u/s 80IB (30% of F) | 1.36 | | | | |
| H. | Subtotal | 3.16 | | | | |
| I. | Income Tax | 1.16 | | | | |
| J. | Net Profit After Tax | 2.01 | | | | |

6.3 ACTIVITY

On the basis of statement given above for the first year, calculate projections of profit chargeable to tax for the IInd, IIIrd, IVth and Vth years. The rate of tax etc. used in preparing the statement given above should be used to calculate projected tax.

Taxation Statement

Preparation of
Taxation Statement

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|--|------|------|------|------|------|
| A. | Net Profit Before Tax (refer Practical Exercise 5) | 8.86 | ---- | ---- | ---- | ---- |
| B. | Add Depreciation as per Project (refer Practical Exercise 2) | 0.91 | ---- | ---- | ---- | ---- |
| C. | Less Depreciation as per Income Tax (refer Practical Exercise 2) | 5.25 | ---- | ---- | ---- | ---- |
| D. | Subtotal (A+B-C) | 4.52 | ---- | ---- | ---- | ---- |
| E. | Less Unabsorbed Losses of Earlier Years | | 0.00 | 0.00 | 0.00 | 0.00 |
| F. | Subtotal | 4.52 | ---- | ---- | ---- | ---- |
| G. | Deduction u/s 80IB (30% of F) | 1.36 | ---- | ---- | ---- | ---- |
| H. | Subtotal | 3.16 | ---- | ---- | ---- | ---- |
| I. | Income Tax | 1.16 | ---- | ---- | ---- | ---- |
| J. | Net Profit After Tax | 2.01 | ---- | ---- | ---- | ---- |

6.4 IMPORTANT CONSIDERATIONS

1. The rate of income tax, including surcharge, education cess must be ascertained at the time when project report is prepared so that correct rate is applied for calculating the tax.
2. Adjustment of depreciation must be made as per the income tax provisions prevailing at the time of preparation of project report.
3. Other deductions which are available for adjustment from net profit must be taken care of before calculating income tax.

6.5 ANSWER TO ACTIVITY

Taxation Statement

| Sl. No. | Particulars | I | II | III | IV | V |
|---------|---|------|-------|-------|-------|-------|
| A. | Net Profit Before Tax | 8.86 | 11.79 | 14.72 | 17.64 | 17.86 |
| B. | Add Depreciation as per Project | 0.91 | 0.91 | 0.91 | 0.91 | 0.91 |
| C. | Less Depreciation as per Income Tax | 5.25 | 3.94 | 2.95 | 2.21 | 1.66 |
| D. | Subtotal (A+B-C) | 4.52 | 8.76 | 12.67 | 16.33 | 17.11 |
| E. | Less Unabsorbed Losses of Earlier Years | | 0.00 | 0.00 | 0.00 | 0.00 |
| F. | Subtotal | 4.52 | 8.76 | 12.67 | 16.33 | 17.11 |
| G. | Deduction u/s 80IB | 1.36 | 2.63 | 3.80 | 4.90 | 5.13 |
| H. | Subtotal | 3.16 | 6.13 | 8.87 | 11.43 | 11.98 |
| I. | Income Tax | 1.16 | 2.24 | 3.24 | 4.18 | 4.38 |
| J. | Net Profit After Tax | 2.01 | 3.89 | 5.63 | 7.25 | 7.60 |

EXERCISE 7 PREPARATION OF BALANCE SHEET

Structure

- 7.1 Introduction
 - Objective
- 7.2 Taxation Statement
 - Practical Example
 - Preparation of the Balance Sheet
- 7.3 Activity
 - Hints for Preparing Balance Sheet for Remaining Four Years
- 7.4 Important Considerations
- 7.5 Answer to Activity

7.1 INTRODUCTION

Balance sheet is a statement prepared by the entrepreneur at the end of the financial year. It depicts the financial position of his firm. The financial soundness of the unit is thereby judged and analysed. It contains the various sources of funds i.e. funds obtained from long term sources and also from short term sources. And further how these funds have been used in the form of various fixed and current assets.

Objective

After going through this exercise, you should be able to:

- prepare the balance sheet.

7.2 BALANCE SHEET

Balance sheet is a yearly document prepared at the end of financial year. It is summary of various sources of funds and the application of such funds. Following format (indicating projections for five years) may be used to prepare balance sheet:

Format of Balance Sheet

| Sl. No. | Particulars | Construction Period | I | II | III | IV | V |
|-----------|-------------------------|---------------------|---|----|-----|----|---|
| A. | <i>SOURCES OF FUNDS</i> | | | | | | |
| | 1. Corpus Capital | | | | | | |
| | 2. Reserves and Surplus | | | | | | |
| | 3. Subsidies | | | | | | |
| | 4. Term Liabilities | | | | | | |
| | a) Secured Term Loan | | | | | | |
| | b) Unsecured Term Loan | | | | | | |
| | c) Subtotal | | | | | | |

| | | | | | | | |
|------------------------|---------------------------------|--|--|--|--|--|--|
| | 5. Current Liabilities | | | | | | |
| | a) Expenses Payable | | | | | | |
| | b) Bank Borrowing for WC | | | | | | |
| | c) Subtotal | | | | | | |
| FUNDS AVAILABLE | | | | | | | |
| B. | <i>APPLICATION OF FUNDS</i> | | | | | | |
| | 1. Fixed Assets | | | | | | |
| | a) Capital Expenditure | | | | | | |
| | b) Capital WIP | | | | | | |
| | c) Subtotal | | | | | | |
| | 2. Investments | | | | | | |
| | 3. Current Assets | | | | | | |
| | a) Stocks of Raw Material | | | | | | |
| | b) Sundry Debtors | | | | | | |
| | c) Advances to Staff | | | | | | |
| | d) Cash and Bank | | | | | | |
| | e) Other Current Assets | | | | | | |
| | f) Subtotal | | | | | | |
| | 4. Miscellaneous Expenditure | | | | | | |
| | 5. Profit & Loss A/c (Dr. bal.) | | | | | | |
| FUNDS UTILISED | | | | | | | |

7.2.1 Practical Example

Let us now have a look at the practical example given below. In this example balance sheet has been prepared for the first year. Figures shown under 'construction period' are opening figures.

Balance Sheet

Preparation of
Balance Sheet

| Sl. No. | Particulars | Construction Period | I |
|-----------|--|---------------------|--------------|
| A. | <i>SOURCES OF FUNDS</i> | | |
| | 1. Corpus Capital (refer Practical Exercise 1) | 11.00 | 11.00 |
| | 2. Reserves and Surplus | 0.00 | 7.70 |
| | 3. Subsidies | 0.00 | 0.00 |
| | 4. Term Liabilities | | |
| | c) Secured Term Loan (refer Practical Exercise 1) | 15.00 | 12.00 |
| | d) Unsecured Term Loan (refer Practical Exercise 1) | 2.76 | 2.76 |
| | c) Subtotal | 17.76 | 14.76 |
| | 5. Current Liabilities | | |
| | a) Expenses Payable | 0.00 | 3.21 |
| | b) Bank Borrowing for WC (refer Practical Exercise 4) | 0.00 | 15.55 |
| | c) Subtotal | 0.00 | 18.76 |
| | FUNDS AVAILABLE | 28.76 | 52.22 |
| B. | <i>APPLICATION OF FUNDS</i> | | |
| | 1. Fixed Assets | | |
| | a) Capital Expenditure | 0.00 | 20.09 |
| | b) Capital WIP | 21.00 | 0.00 |
| | c) Subtotal | 21.00 | 20.09 |
| | 2. Investments | 0.00 | 0.00 |
| | 3. Current Assets | | |
| | a) Stocks of Raw Material (refer Practical Exercise 4) | | 12.49 |
| | b) Sundry Debtors (refer Practical Exercise 4) | | 8.83 |
| | c) Advances to Staff | | 1.50 |
| | d) Cash and Bank | 7.26 | 8.41 |
| | e) Other Current Assets | | 0.50 |
| | f) Subtotal | 7.26 | 31.73 |
| | 4. Miscellaneous Expenditure | 0.50 | 0.40 |
| | 5. Profit & Loss A/c (Dr. bal.) | | 0.00 |
| | FUNDS UTILISED | 28.76 | 52.22 |
| | Current Ratio | | 1.69 |

7.2.2 Preparation of the Balance Sheet

Balance sheet comprises of various figures obtained from different statements already prepared. However, certain figures, which need explanation, are as under:

- *Reserve and surplus*

Year I: Net profit of Ist year Rs. 7.70 lacs (refer Practical Exercise 5)

- *Secured loan for Ist year*

Term loan of Rs. 15.00 lacs obtainable from bank is proposed to be repaid in yearly instalment of Rs. 3.00 lacs. At the end of first year after repayment of Rs. 3.00 lacs the remaining liability of Rs. 12.00 lacs has been shown under this head.

- *Expenses payable*

It is assumed that at the end of the accounting period, certain expenses equivalent to half month remain payable. Thus there is a liability to pay them in the next year. These expenses are:

- Raw material: $53.53/24 = 2.24$ lacs
- Packing material: $21.41/24 = 0.89$ lacs
- General administration: $2.00/24 = 0.08$ lacs

Total expenses payable (Ist year) = $2.24 + 0.89 + 0.08 = 3.21$ lacs

- *Fixed assets*

Under 'construction period' expenditure of Rs. 21.00 lacs on fixed assets is shown under Capital WIP (Capital Work-in-Progress). Thereafter, at the end of first year the amount is transferred to Capital Expenditure. After charging depreciation of Re. 0.91 lac (SLM method), the final figure of Rs. 21.09 is shown under this head.

- *Advances to staff*

Advances given to staff members at the end of first year are assumed to be to the tune of Rs. 1.50 lacs.

- *Other current assets*

There may be certain current assets like prepaid expenses. Under this head in the first year Re. 0.50 lacs has been shown.

- *Cash and bank*

i) Under construction period total funds available are to the tune of Rs.28.76 lacs (refer Means of Finance given in Practical Exercise 1). Out of these funds a sum of Rs. 21.00 lacs has been used for purchasing plant and machinery (i.e. Capital WIP). A sum of Re. 0.50 lacs has been used for meeting preoperative expenses. Remaining Rs. 7.26 lacs

being cash balance has been shown under 'Cash and Bank' (i.e. Rs.28.76 – 21.00 – 0.50).

- ii) At the end of first year total funds available are Rs. 52.22 lacs. After utilising these funds on various fixed and current assets, the remaining balance of Rs. 8.41 has been shown under the head 'Cash and Bank'.

• *Current ratio*

Current ratio shown below the balance sheet is not part of balance sheet. It is based on the figures of current assets and current liabilities shown in the balance sheet. Formula for calculating current ratio (CR) is:

$$CR = \text{Current Assets/Current Liabilities (i.e. } 31.73/18.76 = 1.69)$$

7.3 ACTIVITY

On the basis of balance sheet given above for the first year, calculate projections for the next four years. Basis for preparing balance sheet of subsequent years shall be similar to workings used for the first year.

Balance Sheet

| Sl. No. | Particulars | Construction Period | I | II | III | IV | V |
|---------|--------------------------|---------------------|--------------|------|------|------|------|
| | 1. Corpus Capital | 11.00 | 11.00 | ---- | ---- | ---- | ---- |
| | 2. Reserves and Surplus | 0.00 | 7.70 | ---- | ---- | ---- | ---- |
| | 3. Subsidies | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | 4. Term Liabilities | | | | | | |
| | e) Secured Term Loan | 15.00 | 12.00 | ---- | ---- | ---- | ---- |
| | f) Unsecured Term Loan | 2.76 | 2.76 | ---- | ---- | ---- | ---- |
| | c) Subtotal | 17.76 | 14.76 | ---- | ---- | ---- | ---- |
| | 5. Current Liabilities | | | | | | |
| | a) Expenses Payable | 0.00 | 3.21 | ---- | ---- | ---- | ---- |
| | b) Bank Borrowing for WC | 0.00 | 15.55 | ---- | ---- | ---- | ---- |
| | c) Subtotal | 0.00 | 18.76 | ---- | ---- | ---- | ---- |
| | FUNDS AVAILABLE | 28.76 | 52.22 | ---- | ---- | ---- | ---- |
| | 1. Fixed Assets | | | | | | |
| | a) Capital Expenditure | 0.00 | 20.09 | ---- | ---- | ---- | ---- |
| | b) Capital WIP | 21.00 | 0.00 | ---- | ---- | ---- | ---- |
| | c) Subtotal | 21.00 | 20.09 | ---- | ---- | ---- | ---- |
| | 2. Investments | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

| | | | | | | | |
|--|---------------------------------|--------------|--------------|------|------|------|------|
| | 3. Current Assets | | | | | | |
| | a) Stocks of Raw Material | | 12.49 | ---- | ---- | ---- | ---- |
| | b) Sundry Debtors | | 8.83 | ---- | ---- | ---- | ---- |
| | c) Advances to Staff | | 1.50 | ---- | ---- | ---- | ---- |
| | d) Cash and Bank | 7.26 | 8.41 | ---- | ---- | ---- | ---- |
| | e) Other Current Assets | | 0.50 | ---- | ---- | ---- | ---- |
| | f) Subtotal | 7.26 | 31.73 | ---- | ---- | ---- | ---- |
| | 4. Miscellaneous Expenditure | 0.50 | 0.40 | ---- | ---- | ---- | ---- |
| | 5. Profit & Loss A/c (Dr. bal.) | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | FUNDS UTILISED | 28.76 | 52.22 | ---- | ---- | ---- | ---- |
| | Current Ratio | | 1.69 | ---- | ---- | ---- | ---- |

7.3.1 Hints for Preparing Balance Sheet for remaining four years

- *Reserve and surplus*

Year II: Opening Balance (i.e. Net Profit of Ist Year) + Net Profit of IInd Year = Rs. 7.70 lacs + Rs. 9.55 lacs =Rs. 17.25 lacs

Year III: Opening Balance (i.e. Rs. 17.25 lacs) + Net Profit of IIIrd Year (i.e. Rs. 11.47 lacs) = Rs. 28.72 lacs.

For remaining years also same procedure will be followed.

- *Secured loan for IInd year*

Term loan of Rs. 15.00 after repayment of Rs. 3.00 lacs during the year I becomes Rs. 12.00 lacs at the end of first year. Similarly, after repayment of Rs. 3.00 lacs in the IInd year the liability comes down to Rs. 9.00 lacs which is shown under this head in Year II.

For remaining years also same procedure will be followed and the opening balance under secured loan shall be reduced by Rs. 3.00 lacs per year.

- *Expenses payable*

The assumption that at the end of the accounting period, certain expenses equivalent to half month remain payable is valid for second and subsequent

years. Based on this assumption total expenses payable are to be calculated. These expenses for Year II are:

- Raw material : 64.24/24 = 2.68 lacs
- Packing material : 25.69/24 = 1.07 lacs
- General administration : 2.10/24 = 0.08 lacs

Total expenses payable (IInd Year) = 2.68+1.07+0.08 = 3.83 lacs

For remaining years also same procedure will be followed:

- *Fixed assets*

Depreciated figures of fixed assets for IInd and subsequent years can be obtained from the Depreciation Schedule (SLM) – refer Practical Exercise 2.

- *Advances to staff*

Advances given to staff members at the end of first year were assumed to be to the tune of Rs. 1.50 lacs. This figure is to be increased by 10% in IInd and subsequent years.

- *Other current assets*

Under this head in the first year Re. 0.50 lacs was shown. The figures for the IInd and subsequent years may be assumed as under:

| | |
|----------|------|
| Year II | 1.00 |
| Year III | 2.00 |
| Year IV | 3.00 |
| Year V | 4.00 |

- *Cash and bank*

At the end of first year total funds available were Rs. 52.22 lacs. After utilising these funds on various fixed and current assets, the remaining balance of Rs. 8.41 was shown under the head 'Cash and Bank'.

Similar procedure is to be followed for IInd and subsequent years.

- *Current ratio*

Current ratio for IInd and subsequent years is to be calculated based on the following formula:

$$\text{CR} = \text{Current Assets/Current Liabilities}$$

CR for IInd year = 43.03/22.50 = 1.91).

Similar procedure is to be followed for subsequent years.

7.4 IMPORTANT CONSIDERATIONS

1. A balance sheet is prepared at the end of the accounting period. Accounting period generally corresponds financial year.
2. Following equations may be used for calculating:
 - Sources of Funds = Share Capital + Reserves and Surplus + Long and Short Term Liabilities; and
 - Application of Funds = Fixed Assets + Investment + Current Assets + Fictitious Assets
3. Assumption regarding expenses payable must be realistic.

7.5 ANSWER TO ACTIVITY

Balance Sheet

| Sl. No. | Particulars | Construction Period | I | II | III | IV | V |
|---------|--------------------------|---------------------|--------------|--------------|--------------|--------------|--------------|
| | 1. Corpus Capital | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 |
| | 2. Reserves and Surplus | 0.00 | 7.70 | 17.25 | 28.72 | 42.18 | 55.66 |
| | 3. Subsidies | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | 4. Term Liabilities | | | | | | |
| | g) Secured Term Loan | 15.00 | 12.00 | 9.00 | 6.00 | 3.00 | 0.00 |
| | h) Unsecured Term Loan | 2.76 | 2.76 | 2.76 | 2.76 | 2.76 | 2.76 |
| | c) Subtotal | 17.76 | 14.76 | 11.76 | 8.76 | 5.76 | 2.76 |
| | 5. Current Liabilities | | | | | | |
| | a) Expenses Payable | 0.00 | 3.21 | 3.83 | 4.46 | 5.09 | 5.10 |
| | b) Bank Borrowing for WC | 0.00 | 15.55 | 18.66 | 21.77 | 24.88 | 24.88 |
| | c) Subtotal | 0.00 | 18.76 | 22.50 | 26.24 | 29.97 | 29.98 |
| | FUNDS AVAILABLE | 28.76 | 52.22 | 62.51 | 74.72 | 88.91 | 99.40 |
| | 1. Fixed Assets | | | | | | |
| | a) Capital Expenditure | 0.00 | 20.09 | 19.18 | 18.27 | 17.36 | 16.45 |
| | b) Capital WIP | 21.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | c) Subtotal | 21.00 | 20.09 | 19.18 | 18.27 | 17.36 | 16.45 |
| | 2. Investments | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

**Preparation of
Balance Sheet**

| | | | | | | | |
|---------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--|
| 3. Current Assets | | | | | | | |
| a) Stocks of Raw Material | | 12.49 | 14.99 | 17.49 | 19.98 | 19.98 | |
| b) Sundry Debtors | | 8.83 | 10.60 | 12.37 | 14.13 | 14.13 | |
| c) Advances to Staff | | 1.50 | 1.65 | 1.82 | 2.00 | 2.20 | |
| d) Cash and Bank | 7.26 | 8.41 | 14.79 | 22.58 | 32.33 | 42.63 | |
| e) Other Current Assets | | 0.50 | 1.00 | 2.00 | 3.00 | 4.00 | |
| f) Subtotal | 7.26 | 31.73 | 43.03 | 56.25 | 71.45 | 82.95 | |
| 4. Miscellaneous Expenditure | 0.50 | 0.40 | 0.30 | 0.20 | 0.10 | 0.00 | |
| 5. Profit & Loss A/c (Dr. bal.) | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | |
| FUNDS UTILISED | 28.76 | 52.22 | 62.51 | 74.72 | 88.91 | 99.40 | |
| Current Ratio | | 1.69 | 1.91 | 2.14 | 2.38 | 2.77 | |

EXERCISE 8 PREPARATION OF BREAK EVEN ANALYSIS STATEMENT

Structure

- 8.1 Introduction
 - Objective
- 8.2 Statement of Break Even Analysis
 - Formula for Calculating Break Even Point
 - Practical Example
- 8.3 Important Considerations

8.1 INTRODUCTION

Break-even analysis is one of the controlling devices which is used by bankers to evaluate a project. It is an important tool of profit planning. It is also called cost-volume-profit (CVP) analysis. It facilitates cost control by measuring operational efficiency. At break-even point the project neither makes profit nor incurs losses.

Objective

After going through this exercise, you should be able to:

- calculate break-even point.

8.2 STATEMENT OF BREAK EVEN ANALYSIS

For calculating break-even point we need to understand the following concepts:

- i) *Fixed costs*: Fixed costs (FC) are those costs which remain constant whether there is increase or decrease in production over a given period of time. These costs are fixed in nature and are incurred as soon as the business is started. This concept of fixed costs remains valid up to a particular level of operation.
- ii) *Variable costs*: Variable costs (VC) are those costs which vary according to the level of production attained. They will increase if the production is increased even by one unit or decrease when there is decrease in production.
- iii) *Selling price/income*: Selling price is that price at which the goods are sold. This is the revenue generated by the business.
- iv) *Contribution margin*: Contribution margin is the difference between selling price and the variable cost. In other words:

$$\text{Contribution Margin} = \text{Selling Price} - \text{Variable cost}$$

It may be noted that for calculating contribution margin, fixed cost is not considered.

8.2.1 Formula for Calculating Break Even Point

After understanding the above concepts, we can move on to calculate break-even point (BEP) with the help of following formula:

$$BEP = \frac{\text{Fixed Costs}}{\text{Contribution Margin}}$$

8.2.2 Practical Example

Using the figures related to the year of optimum operation i.e. Year IV (refer Practical Exercise 5), following Break Even Analysis Statement has been prepared:

Break Even Analysis

| Sl. No. | Particulars | | | Amount |
|-----------|--|----|---|---------------|
| A. | <i>INCOME</i> | | | 169.60 |
| B. | <i>VARIABLE COST</i> | | | |
| | Cost of Material | 95 | % | 81.37 |
| | Cost of Packing Material | 95 | % | 32.55 |
| | Salary & Wages | 80 | % | 17.13 |
| | Power & Fuel | 80 | % | 3.15 |
| | General Administration | 85 | % | 1.97 |
| | Interest on WC Loan | | | 2.86 |
| | Sub Total | | | 139.02 |
| C. | <i>CONTRIBUTION (A-B)</i> | | | 30.58 |
| D. | <i>FIXED COST</i> | | | |
| | Cost of Material | 5 | % | 4.28 |
| | Cost of Packing Material | 5 | % | 1.71 |
| | Salary & Wages | 20 | % | 4.28 |
| | Power & Fuel | 20 | % | 0.79 |
| | General Administration | 15 | % | 0.35 |
| | Interest on Term Loan | | | 0.52 |
| | Depreciation | | | 0.91 |
| | Preliminary Expenses W/O | | | 0.10 |
| | Sub Total | | | 12.94 |
| E. | <i>BREAK EVEN POINT (%)</i> <i>(FIXED COST/CONTRIBUTION)*</i> <i>CAPACITY UTILISATION</i> <i>(12.94 / 30.58) * 80</i> | | | 33.86 |

(Hint: In the above statement percentages indicated against each head of expenditure have been used for calculating fixed and variable costs. We may take the example of cost of material which is Rs. 85.65 lacs in the IVth year. 95% of it i.e. Rs. 81.37 has been considered as variable cost whereas the remaining 5% of it (i.e. Rs. 4.28 lacs) has been treated as fixed cost. Interest on Working Capital loan is a variable cost whereas interest on Term Loan is a fixed cost. Both depreciation and preoperative expenses w/o have been considered as fixed cost.)

8.3 IMPORTANT CONSIDERATIONS

1. Fixed and variable costs must be segregated in a judicious manner. This will give a realistic break even point.
2. Assumptions regarding percentages to be applied in classifying a particular cost into variable and fixed must be based on trend prevalent in the industry to which the product to be manufactured belongs.
3. The basis for calculating break even point should be that year in which optimum operation is expected to be achieved.

EXERCISE 9 PREPARATION OF STATEMENT OF POWER CALCULATION

Structure

- 9.1 Introduction
Objective
- 9.2 Statement of Power Calculation
Practical Example
- 9.3 Activity
- 9.4 Important Considerations
- 9.5 Answer to Activity

9.1 INTRODUCTION

Power and fuel play an important role in any project. Without power, production is not possible. Power can be obtained from the State Electricity Board or any other Institution supplying power in the area where the unit is going to be located or can be generated by using own generators or a combination of both.

Objective

After going through this exercise, you should be able to:

- prepare statement of power calculation.

9.2 STATEMENT OF POWER CALCULATION

Before preparing statement of power calculation we must know certain factors like power load required, hours per shift of operation, shifts per day, working days per annum, effective load factor, rate per unit etc.

9.2.1 Practical Example

Let us now have a look at the practical example. In the following statement, total power at 100% capacity of production has been calculated. Thereafter, power cost at 50% capacity utilisation has been calculated.

Statement of Power Calculation

| Sl. No. | Particulars | Technical specification |
|---------|-----------------------------|-------------------------|
| 1. | Total Power Load required | 25 KW |
| 2. | Hours/Shift | 8 Hours |
| 3. | Shifts/Day | 3 Shifts |
| 4. | Working Days/Annum | 365 Days |
| 5. | Effective Power/Load Factor | 0.50 |

| | | |
|-----|--|--------------|
| 6. | Units Consumed/Annum (1*2*3*4*5) | 109500 Units |
| 7. | Public Supply of Power | 100% |
| 8. | Own Generation on DG Set | 0% |
| 9. | Units consumed through Public Supply | 109500 Units |
| 10. | Units Consumed through Own Generation | 0 Units |
| 11. | Power Rate of Public Supply/Unit | 4.50 Rs. |
| 12. | Power Rate of Own Generation/Unit | 4.00 Rs. |
| 13. | Power Cost of Public Supply (In'lacs) (9*11) | 4.93 Lacs |
| 14. | Power Cost of Own Generation(In'lacs) | 0.00 Lacs |
| 15. | TOTAL POWER COST AT 100% CAPACITY | 4.93 Lacs |

| | Capacity Utilisation | Power Cost |
|------------------------------|----------------------|------------|
| Power and Fuel in First Year | 50% | 2.46 Lacs |

9.3 ACTIVITY

Based on the fact that power cost at 100% capacity utilisation is Rs. 4.93 lacs, calculate power and fuel cost in IInd, IIIrd, IVth and Vth years when the capacity utilisation is at 60%, 70%, 80% and 80% respectively.

| | Capacity Utilisation | Power Cost |
|-------------------------------|----------------------|------------|
| Power and Fuel in First Year | 50% | 2.46 Lacs |
| Power and Fuel in Second Year | 60% | ----- Lacs |
| Power and Fuel in Third Year | 70% | ----- Lacs |
| Power and Fuel in Fourth Year | 80% | ----- Lacs |
| Power and Fuel in Fifth Year | 80% | ----- Lacs |

9.4 IMPORTANT CONSIDERATIONS

1. Based on the installed capacity of the plant as well as other requirements, power load required should be judged accurately.
2. Required power load should also take care of expansions in the near future.
3. The decision regarding shifts to be worked per day and the working hours per day must be taken judiciously.
4. Ideally the factory should run for 365 days in a year. Based on this the calculation at 100% capacity utilisation should be made. This will give us the cost of power as realistic as possible.
5. If facility for generating own power through generation sets is available, provision should be made in this respect also besides making provision for public supply of power.

9.5 ANSWER TO ACTIVITY

**Preparation of
Statement of Power
Calculation**

| | Capacity Utilisation | Power Cost |
|-------------------------------|-----------------------------|-------------------|
| Power and Fuel in First Year | 50% | 2.46 Lacs |
| Power and Fuel in Second Year | 60% | 2.96 Lacs |
| Power and Fuel in Third Year | 70% | 3.45 Lacs |
| Power and Fuel in Fourth Year | 80% | 3.94 Lacs |
| Power and Fuel in Fifth Year | 80% | 3.94 Lacs |