ENTREPRENEURSHIP DEVELOPMENT

M-246

Self Learning Material

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UNIT 1 ENTREPRENEURSHIP

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★ STRUCTURE ★

1.0 LEARNING OBJECTIVES

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

define what is entrepreneur?

explain internal and external factors.

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- describe function of entrepreneur.
- differentiate between theory of entrepreneurship and concept of entrepreneurship.
- discuss about the development of entrepreneurship and culture of stages in entrepreneurial process.

1.1 INTRODUCTION

The word 'entrepreneur' is derived from French word 'Entreprendre' which was used to designate an organizer of musical or other entertainments. Later in 16th century it was used for army leaders. It was extended to cover civil engineering activities such as construction in 17th century. But it was Richard Cantillon, an Irishman living in France who first used the term entrepreneur to refer to economic activities. According to Cantillon "An entrepreneur is a person who buys factor services at certain prices with a view to selling its product at uncertain prices". Entrepreneur, according to Cantillon, an entrepreneur is a bearer of risk, which is non-insurable. SchumPeter gave a central position to the entrepreneur who believed that an entrepreneur was a dynamic agent of change; that an entrepreneur was a catalyst who transformed increasingly physical, natural and human resources into correspondingly production possibilities. Since then the term entrepreneur is used in various ways and various views.

1.2 DEFINITION OF ENTREPRENEUR

As said above entrepreneur is used in various ways and various views. These views are broadly classified into three groups, namely risk bearer, organizer and innovator.

***Entrepreneur as Risk Bearer*:** Richard Cantilon defined entrepreneur as an agent who buys factors as production at certain prices in order to combine them into a product with a view to selling it at uncertain prices in future. He illustrated a former who pays contractual incomes, which are certain to land owners and laborers and sells at prices that are 'uncertain'. He includes merchants also who make certain payments in expectation of uncertain receipts. Hence both of them are risk-bearing agents of production. P.H. Knight described entrepreneur to be a specialized group of persons who bear uncertainty. Uncertainty is defined as risk, which cannot be insured against and is incalculable. He made distinction between certainty and risk. A risk can be reduced through the insurance principle, where the distribution of outcome in a group of instance is known, whereas uncertainty cannot be calculated.

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***Entrepreneur as an Organizer*:** According to J Baptist Say "an entrepreneur is one who combines the land of one, the labor of another and capital of yet another, and thus produces a product. By selling the product in the market, he pays interest on capital, rent on land and wages to laborers and what remains is his/her profit". Say made distinction between the role of capitalist as a financer and the entrepreneur as an organizer. This concept of entrepreneur is associated with the functions of coordination, organisation and supervision.

***Entrepreneur as an Innovator*:** Joseph A SchumPeter in 1934 assigned a crucial role of 'innovation' to the entrepreneur. He considered economic development as a dynamic change brought by entrepreneur by instituting new combinations of factors of production, *i.e.,* innovations. The introduction of new combination according to him, may occur in any of the following forms.

(*a*) Introduction of new product in the market.

(*b*) Use of new method of production, which is not yet tested.

(*c*) Opening of new market.

(*d*) Discovery of new source of raw materials.

(*e*) Bringing out of new form of organisation.

SchumPeter also made distinction between inventor and innovator. An inventor is one who discovers new methods and new materials. An innovator utilizes inventions and discovers in order to make new combinations.

Hence the concept of entrepreneur is associated with three elements riskbearing, organizing and innovating. Hence *an entrepreneur can be defined as a person who tries to create something new, organizes production and undertakes risks and handles economic uncertainty involved in enterprise.*

Some more important definitions of entrepreneur

1. ***According to F.A.Walker*:** "Entrepreneur is one who is endowed with more than average capacities in the task of organizing and coordinating the factors of production, *i.e.,* land, labour capital and enterprises".
2. ***Marx*** regarded entrepreneur as social parasite.
3. ***According to Gilbraith*:** "An entrepreneur must accept the challenge and should be willing hard to achieve something".
4. ***Peter F. Drucker*** defines an entrepreneur as one who always searches for change, responds to it and exploits it as an opportunity. Innovation is the basic tool of entrepreneurs, the means by which they exploit change as an opportunity for a different business or service.
5. ***According to E.E.Hagen*:** "An entrepreneur is an economic man who tries to maximize his profits by innovation, involve problem solving and gets satisfaction from using his capabilities on attacking problems".

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6. ***According to Mark Casson:*** "An entrepreneur is a person who specializes in taking judgmental decision about the coordination of scarce resources".
7. ***Frank Young*** defined entrepreneur as a change agent.
8. ***According to Max Weber:*** "Entrepreneurs are a product of particular social condition in which they are brought up and it is the society which shapes individuals as entrepreneurs".
9. ***International Labour Organization (ILO)*** defines entrepreneurs as those people who have the ability to see and evaluate business opportunities, together with the necessary resources to take advantage of them and to initiate appropriate action to ensure success.
10. ***Akhouri*** describes entrepreneur as a character who combines innovativeness, readiness to take risk, sensing opportunities, identifying and mobilizing potential resources, concern for excellence, and who is persistent in achieving the goal.

1.3 INTERNAL AND EXTERNAL FACTORS OF ENTREPRENEUR

Entrepreneur is a person of telescopic faculty drive and talent who perceives business opportunities and promptly seizes them for exploitation. Entrepreneur needs to possess competencies to perform entrepreneur activities. Table 1.1 gives core competencies.

Table 1.1: Personal entrepreneurial characteristics

	Core Competencies	***Entrepreneurial Activities***
1.	Initiative	Does things before asked for or forced to by events and acts to extend the business to new areas, products or services.
2.	Perceiving opportunities	Identifies business opportunities and mobilizes necessary resources to make good an opportunity.
3.	Persistence	Takes repeated or different actions to overcome obstacles.
4.	Information gathering	Consults experts for business and technical advice. Seeks information of client or supplier's needs. Personally undertakes market research and make use of personal contacts or information networks to obtain useful information.
5.	Concern for quality work	States desire to produce or sell a better quality product or service. Compares his performance favourably with that of others.

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6.	Commitment to contractual obligations	Makes a personal sacrifice or expands extraordinary effort to complete a job, accepts full responsibility in completing a job contract on schedule, pitches in with workers or work in their place to get the job done and shows ulmost concern to satisfy the customer.
7.	Efficiency orientation	Finds ways and means to do things faster, better and economically.
8.	Planning	Various inter-related jobs are synchronized according to plan.
9.	Problem solving	Conceives new ideas and finds innovative solutions.
10.	Self-confidence	Makes decisions on his own and sticks to it in spite of initial setbacks.
11.	Experience	Possesses technical expertise in areas of business, finance, marketing, etc.
12.	Self-critical	Aware of personal limitations but tries to improve upon by learning from his past mistakes or experiences of others and is never complacent with success.
13.	Persuasion	Persuades customers and financiers to patronize his business.
14.	Use of influence strategies	Develops business contacts, retains influential people as agents and restricts dissemination of information in his possession.
15.	Assertiveness	Instructs, reprimands or disciplines for failing to perform.
16.	Monitoring	Develops a reporting system to ensure that work is completed and quality norms.
17.	Credibility	Demonstrates honesty in dealing with employees, suppliers and customers even if it means a loss of business.
18.	Concern for employee welfare	Express concern for employees by responding promptly to their grievances.
19.	Impersonal relationship	Places long-term goodwill over short-term gain in a business relationship.
20.	Expansion of capital base	Reinvests a greater portion of profits to expand capital of the firm.
21.	Building product image	Concerned about the image of his products among consumers and does everything possible to establish a niche for his products in the market.

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1.4 FUNCTIONS OF AN ENTREPRENEUR

An Entrepreneur has to perform a number of functions right from the generation of idea up to the establishment of an enterprise. He also has to perform functions for successful running of his enterprise. Entrepreneur has to perceive business opportunities and mobilize resources like man, money, machines, materials and methods. The following are the main functions of an Entrepreneur.

1. ***Idea Generation*:** The first and the most important function of an Entrepreneur is idea generation. Idea generation implies product selection and project identification. Idea generation is possible through vision, insight, keen observation, education, experience and exposure. This needs scanning of business environment and market survey.
2. ***Determination of Business Objectives*:** Entrepreneur has to state and lay down the business objectives. Objectives should be spelt out in clear terms. The Entrepreneur must be clear about the nature and type of business, *i.e.*, whether manufacturing concern or service oriented unit or a trading business so that he can very well carry on the venture in accordance with the objectives determined by him.
3. ***Rising of Funds*:** All the activities of the business depend upon the finance and hence fund rising is an important function of an Entrepreneur. An Entrepreneur can raise the fund from internal source as well as external source. He should be aware of different sources of funds. He should also have complete knowledge of government sponsored schemes such as PMRY, SASY, REAP etc., in which he can get government assistance in the form of seed capital, fixed and working capital for his business.
4. ***Procurement of Machines and Materials*:** Another important function of an Entrepreneur is to procure raw materials and machines. Entrepreneur has to Identify cheap and regular sources of raw materials which will help him to reduce the cost of production and face competition boldly. While procuring machineries he should specify the technical details and the capacity. He should consider the warranty, after sales service facilities etc., before procuring machineries.
5. ***Market Research*:** Market research is the systematic collection of data regarding the product which the Entrepreneur wants to manufacture. Entrepreneur has to undertake market research persistently to know the details of the intending product, *i.e.*, the demand for the product, size of the market/customers, the supply of the product, competition, the price of the product etc.
6. ***Determining form of Enterprise*:** Entrepreneur has to determine form of enterprise depending upon the nature of the product, volume of

investment etc. The forms of ownership are sole proprietorship, partnership, Joint Stock Company, co-operative society etc. Determination of ownership right is essential on the part of the entrepreneur to acquire legal title to assets.

7. ***Recruitment of Manpower***: To carry out this function an Entrepreneur has to perform the following activities.

   (*a*) Estimating man power requirement for short term and long term.

   (*b*) Laying down the selection procedure.

   (*c*) Designing scheme of compensation.

   (*d*) Laying down the service rules.

   (*e*) Designing mechanism for training and development.

8. ***Implementation of the Project***: Entrepreneur has to develop schedule and action plan for the implementation of the project. The project must be implemented in a time bound manner. All the activities from the conception stage to the commissioning stage are to be accomplished by him in accordance with the implementation schedule to avoid cost and time overrun. He has to organize various resources and coordinate various activities. This implementation of the project is an important function of the Entrepreneur. All the above functions of the Entrepreneur can precisely be put into three categories of innovation, risk bearing, and organizing and managing functions.

1.5 TYPES OF ENTREPRENEUR

Today various types of Entrepreneurs are found engaged in different types of activities, not only in industrial activities but also in agriculture and commercial activities. Today we can recognize Entrepreneur in industry, service and business sectors which are technically called as ISB sectors. Entrepreneurs are classified in a number of ways as discussed below.

Clearance Danhof's Classifications

Danhof classifies Entrepreneur into four types.

1. ***Innovative Entrepreneur***: This category of Entrepreneur is characterized by smell of innovativeness. This type of Entrepreneur, sense the opportunities for introduction of new ideas, new technology, discovering of new markets and creating new organizations. Such Entrepreneur can work only when certain level of development is already achieved and people look forward to change and improve. Such Entrepreneur are very much helpful for their country because they bring about a transformation in life style.

2. ***Adoptive or Imitative Entrepreneur*:** Such entrepreneurs imitate the existing entrepreneur and set their enterprise in the same manner. Instead of innovation, may just adopt the technology and methods innovated by others. Such types of entrepreneur are particularly suitable for under-developed countries for imitating the new combination of production already available in developed countries.
3. ***Fabian Entrepreneurs*:** Fabian entrepreneurs are characterized by great caution and skepticism, in experimenting any change in their enterprises. They imitate only when it becomes perfectly clear that failure to do so would result in a loss of the relative position in the enterprises.
4. ***Drone Entrepreneurs*:** Such entrepreneurs are conservative or orthodox in outlook. They always feel comfortable with their old fashioned technology of production even though technologies have changed. They never like to get rid of their traditional business, traditional machineries and traditional system of business even at the cost of reduced returns.

Arthur H Cole Classification

Arthur H Cole classifies entrepreneurs as empirical, rational and cognitive entrepreneur.

***Empirical*:** He is entrepreneur hardly introduces anything revolutionary and follows the principle of rule of thumb.

***Rational*:** The rational entrepreneur is well informed about the general economic conditions and introduces changes, which look more revolutionary.

***Cognitive*:** Cognitive entrepreneur is well informed, draws upon the advice and services of experts and introduces changes that reflect complete break from the existing scheme of enterprise.

Classification Based on the Scale of Enterprise

***Small Scale*:** These entrepreneurs do not posses the necessary talents and resources to initiate large-scale production and to introduce revolutionary technological changes.

***Large Scale*:** They possess the necessary financial and other resources to initiate and introduce new technological changes. They possess talent and research and development facilities.

Other Classification

Following are some more types of entrepreneurs listed by behavior scientists.

***Solo Operators*:** These are the entrepreneurs who essentially work alone, introduce their own capital and if essential employ very few employees. In the beginning most of the entrepreneurs start their enterprises like them.

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***Active Partners*:** Such entrepreneurs jointly put their efforts and resources. They actively participate in managing the daily routine of the business concern. Entrepreneurs who only contribute their funds but not actively participate in the business are called simply 'Partners'.

***Inventors*:** Such entrepreneurs are creative in character and feel happy in inventing new products, technologies and methods of production. Their basic interest lies in research and innovative activities.

***Challenge*:** According to such entrepreneurs, if there is no challenge in life, there is no charm in life. Such entrepreneurs plunge into industry/business because of the challenge it presents. When one challenge seems to be met, they begin to look for new challenges. They convert odds and adversities into opportunities and make profit.

***Buyers*:** These are the entrepreneurs who do not like to face the hassles of building infrastructure and other facilities. They simply purchase the existing one and by using their experience and expertise try to run the enterprise successfully.

***Life Timers*:** Such entrepreneurs take business as an integral point of their life. Family enterprises, which mainly depend on exercise of personal skill, fall in this category.

***Industrial Entrepreneurs*:** Such entrepreneurs engage in manufacturing and selling products.

***Service Entrepreneurs*:** Such entrepreneurs engage in service activities like repair, consultancy, beauty parlor etc., where entrepreneurs provide service to people.

***Business Entrepreneurs*:** They are also called as trading entrepreneurs which buy and sell goods.

***Agricultural Entrepreneurs*:** They engage themselves in agricultural activities like horticulture, floriculture, animal husbandry, poultry etc.

***Corporate Entrepreneurs*:** Corporate entrepreneurs undertake their business activities under legally registered company or trust.

***Rural Entrepreneurs*:** Entrepreneur's selecting rural-based industrial opportunity in either khadi or village industries sector or in farm entrepreneurship are regarded as rural entrepreneurs. According to khadi and village industry commission (KVIC) Village or rural industry means any industry located in rural area, population of which do not exceed 10,000 which produces any goods or services in which fixed investment of an artisan or a worker does not exceed one thousand rupees.

***Women Entrepreneurs*:** According to government of India an entrepreneurs is defined as an enterprise owned and controlled by 16 a woman and having

minimum financial interests of 51% of the capital and giving at least 51% of the employment generated in the enterprise to women. Women entrepreneurs play an important role in economy especially in rural areas.

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1.6 CONCEPT OF ENTREPRENEURSHIP

Entrepreneurship is an elusive concept. The concept of entrepreneurship has been a subject of much debate and is defined differently by different authors. Some of them view it as 'risk-bearing'; others call it as 'innovations', yet others consider it as 'thrillseeking'.

In a conference of entrepreneurship held in USA, it is defined, as *"Entrepreneurship is the attempt to create value through recognition of business opportunity, the management of risk taking appropriate to the opportunity and through the communicative and management skills to mobilize human, financial and material resources necessary to bring a project to fruition".*

A.H. Cole has defined entrepreneurship as "the purposeful activity of an individual or group of associated individuals, undertaken to initiate, maintain or earn profit by production and distribution of economic goods and services".

According to Heggins "Entrepreneurship is meant the function of seeking investment and production opportunity, organizing an enterprise to undertake a new production process, raising capital, hiring labour, arranging the supply of raw materials and selecting top manager's of day-to-day operations.

According to Joseph A Schempeter entrepreneurship is essentially a creative activity. It consists of doing such things as are not generally done in ordinary course of business. An entrepreneur is one who innovates *i.e.,* carries out new business.

According Mc Clelland, there are two characteristics of entrepreneur: first is doing a thing in a new and better way, second is decision making under uncertainty. The various definitions of entrepreneurship identify two basic elements of entrepreneurship namely innovation and risk bearing.

Innovation: Innovation is doing something new or something different. Entrepreneurs constantly look out to do something different and unique to meet the changing requirements of the customers. Entrepreneurs need not be inventors of new products or new methods of production or service, but may possess the ability of making use of the inventions for their enterprises. For example, in order to satisfy the changing needs of the customers, now-a-days fruit juice (mango, fruits etc.) in being served in tins, instead of bottles so that customers can carry it and throw away the containers after drinking the juice. Ratan Tata did not invent automobile. Foreseeing the peoples desire to have small cars at lower price, he applied new methods of

mass manufacturing, made use of new, lights and relatively cheaper materials. Hence entrepreneurship needs to apply inventions on a continuous basis to meet customers changing demands for products.

***Risk Bearing*:** Giving birth to a new enterprise involves risk. Doing something new and different is also risky. The enterprise may earn profit or incur loss, which depends on various factors like changing customer preferences, increased competition, shortage or raw materials etc. An entrepreneur needs to be bold enough to assume the risk involved and hence an entrepreneur is a risk-bearer not risk-avoider. This risk-bearing ability keeps him to try on and on which ultimately makes him to succeed. The Japanese proverb "Fall seven times, stand up eight" applied to entrepreneur. Though the terms entrepreneur and entrepreneurship are used interchangeable, yet they are conceptually different. The relationship between the two is indicated in Fig. 1.1 and table 1.2.

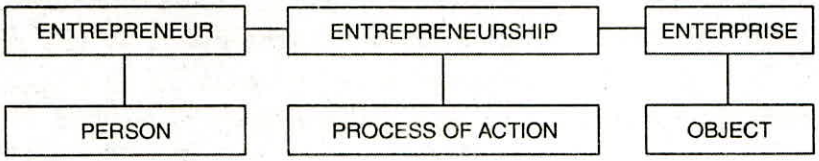

Fig. 1.1. *Concept of entrepreneurship*

Table 1.2: Relationships between entrepreneur and entrepreneurship

Entrepreneur	*Entrepreneurship*
Person	Process
Organizer	Organization
Innovator	Innovation
Risk-bearer	Risk-bearing
Motivator	Motivation
Creator	Creation
Visualizes	Vision
Leader	Leading
Imitator	Imitation

1.7 STAGES IN THE ENTREPRENEURIAL PROCESS

Entrepreneurship is a process of comprising several distinct stages. The first stage in the entrepreneurial process is some change in the real world. For example, a war may destroy country's manufacturing facilities but spare its

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trained work force that has happened in West Germany during Second World War. Such a change leads to changes in every aspect of life in the country. It creates needs for new goods and services. The distraction of Japan's industry during the Second World War allowed the country to rebuild its industry from scratch.

The second stage in the entrepreneurial development is the 'idea'. For example, microprocessor, the brain of personnel computer had been in the American market since the early 1970s. A company called 'Altair' had put out a computer that was so personal that one had to put it together oneself. But it was Apple Computer, which perceived that computer market was potentially very big. One may become an entrepreneur in various ways. He may start a new enterprise. Alternatively he may acquire a franchise. Franchising is an entrepreneurial system whereby an individual runs a business based on the right to make a product or service granted by a manufacturer or other organization. Intrapreneuring is another strategy. It is the process of extending the firms domain of competence by exploiting new opportunities through new combinations of its existing resources.

1.8 BARRIERS TO ENTREPRENEURSHIP

A large number of entrepreneurs particularly in the small enterprises fail due to several problems and barriers. The greatest barrier to entrepreneurship is the failure of success.

Karl. H. Vesper has identified the following entrepreneurship barriers:

1. Lack of a viable concept
2. Lack of market knowledge
3. Lack of technical skills
4. Lack of seed capital
5. Lack of business know how
6. Complacency—lack of motivation
7. Social stigma
8. Time presence and distractions
9. Legal constraints and regulations
10. Monopoly and protectionism
11. Inhibitions due to patents

An entrepreneur is a person who buys factor services at certain prices with a view to selling its products at uncertain prices. Entrepreneur is a dynamic

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agent of change. An entrepreneur is a person of telescopic faculty, drive and talent who perceives business opportunities and promptly seizes them for exploitation. Entrepreneur needs to possess some core competencies like innovative, perceiving opportunities, persistence, information gathering, concern for quality, planning, problem solving etc. a clear distinction can be made between an entrepreneur and a manager. An entrepreneur has to perform various functions like idea generation, determination of business objectives, raising of funds, procurement of machines and materials, market research, deciding forms of ownership, recruitment of man power etc., entrepreneurs can be classified based on various factors. Intrapreneurs take the responsibility of innovation.

Entrepreneurship is purposeful activity of an individual or a group of associated individuals, undertaken to initiate, maintain or earn profit by production and distribution of economic goods or services. It is an act of starting and running an enterprise. Entrepreneurship is as old as ancient history itself and dates back to pre-Vedic period when Harappan culture flourished in India. The artisans and royal patronage of Indian kings have contributed for the entrepreneurship in the early ages of Indian history. East India Company handicapped the Indian tiny and cottage industries. Later Parsi's, Jain's and Vaishya's have contributed for the growth of entrepreneurship. The managing agency system and the Swadeshi movement have contributed for the growth of entrepreneurship in India. After independence, the Government of India has taken measures for growth of industries through her Industry Policy Resolutions. There are many barriers to the entrepreneurship. They may be lack of viable concept, lack of market knowledge, lack of skills, lack of seed capital etc.

1.9 DEVELOPING ENTREPRENEURSHIP

The word entrepreneur entered economic theory more than two centuries ago when a French banker, Cantillon, used this word to signify an undertaker of business. An entrepreneur was visualized as the organizer of the factors of production and supplier of managerial skills. In due course, other economists, historians and social and behavioural scientists gave a broader context to the term.

Research on factors affecting entrepreneurial manifestation has a long history, extending to the field of Economics (Schumpeter), Sociology (Weber) and Psychology (McClelland). A largely shared view, to which I also subscribe in this chapter, is that entrepreneurial activation is the continued result of entrepreneurial opportunities which have an economic, social and organizational origin and of human behaviour that is related to

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entrepreneurial motives. The thrust of this Unit is to evolve action—choices that can activate entrepreneurial behaviour—using available research data from the social sciences and relevant experience. In this sense, entrepreneurship and intrapreneurship are processes that contribute to economic and societal growth.

To pursue the question of entrepreneurial activation, this chapter is divided into four parts:

1. Entrepreneurial behaviour as an attribute of a person
2. Conditions that facilitate entrepreneurship
3. Cultural orientation that supports or discourages entrepreneurial activation
4. Organizational framework for enhanced entrepreneurial effort

The chapter will examine the processes involved in intrapreneurial and entrepreneurial activation and the socio-cultural/organizational considerations that influence these processes.

1.10 ENTREPRENEURIAL BEHAVIOUR

The issue of risk is central to the study of entrepreneurial behaviour and performance. Many studies have associated several characteristics of entrepreneurial behaviour such as strong predilection to (*i*) recognize opportunity; (*ii*) evaluate and judge a situation and (*iii*) make decisions after evaluating risk. Baumbeck and Mancuso (1987) found 'that entrepreneurs are stimulated by achievement itself, rather than by money. Money is a by-product and scorecard for the accomplishment of goals and achievement.' Hornaday and Abound (1971) used two psychological scales to evaluate an entrepreneurial sample. They found that entrepreneurs scored significantly higher in the scale of leadership, independence and need for recognition, and lower in need for support and benevolence. Palmer (1971) found that entrepreneurs are ambitious for personal achievement and show abilities for risk taking and making decisions under uncertainty. Entrepreneurs believe that their personal destiny is a product of their effort. They are independent, autonomous and self-reliant.

Most of the writings about entrepreneurship in India relate to setting up of new enterprises and the qualities needed to succeed. Desai (2000) states that 'Entrepreneurs are individuals motivated by a will for power; their specialist characteristic being an inherent capacity to select correct answers, energy, will and mind to overcome fixed talents of thoughts and a capacity to withstand social opposition ...' (p. 25). There are many books that discuss a step-by-step procedure for setting up a new venture (Jain 1998). The writings bring out problems in starting and managing small enterprises and look at

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the do's and don'ts of starting such initiatives along with providing case studies and documenting personal experiences of setting up a new company.

Indian studies have also highlighted the characteristics that have shown up in Western studies. Entrepreneurs have a strong need for independence (Dayal 1999; Khandwalla 1987). They show impatience with bureaucratic procedures and have low levels of tolerance. In brief, the studies show a consistent profile of entrepreneurial behaviour that may be operationalized. They have a need for higher achievement and have a higher propensity for the following:

- Risk taking
- Identifying and seizing opportunity
- Decision making beyond past and the present trends

Ross and Unwalla (1986) have summarized intrapreneurial personality as:

- Focusing on results, not activity
- Questioning the status quo
- Motivated by problem solving and effecting change and innovation
- Frustrated by bureaucratic systems
- Ambitious and competitive.

1.11 CONDITIONS THAT FACILITATE ENTREPRENEURSHIP

Entrepreneurial activity needs, as almost everything else, a supportive environment. Zahara (1996) emphasizes that corporate entrepreneurship is essential for ensuring survival by periodic renewal of a firm's operations, redefining its business strategies and the product range, and enhancing its innovation capabilities. Such exercises are needed in a dynamic environment. It may be useful to briefly describe how some institutions or business organizations have developed a culture of thinking beyond the proverbial box and adopted processes that encourage individuals to take initiatives in work situations.

Example 1

Institution A had developed a practice of open and free discussion for decision making. The Director encouraged members to raise questions and voice alternative views even when, at times, the discussions led to the raising of voices. He interjected to the extent of summarizing the issues that came up for discussion and identified issues which needed examination, keeping in view the well-being of the institution. Over many months, the problem-solving and decision-making culture was characterized by (*i*) tolerance for ideas;

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(*ii*) decision-criteria that would be in the interest of the institution beyond self interest and (*iii*) openness among the members to bring out new ideas, however weird they sounded.

When new proposals were made to the Director he did not reject them but asked the individual concerned if he saw any reason why the proposal could not be implemented. The individual often saw the impracticality of the proposition or modified it. The institutional management encouraged discussion and interaction between people. Cumulatively such approaches created an environment of acceptance. At the same time, the institution set out high goals of achievement for individuals and also for the institution as a whole. The attainment of the goals was linked to monetary and non-monetary rewards for individuals. The innovations of the individuals were given special recognition (Dayal 1991).

The illustration is provided to suggest the *process* employed by one institution for initiating and encouraging interactions among people to develop shared institutional norms and values. The members felt free to raise new ideas without fear of being ridiculed. The community was not afraid of adopting new ways of thinking so long as they served institutional goals. Conformity and uniformity were not seen to be institutional virtues. The *process* dimension (*i.e.*, how issues are handled and resolved) in people-related issues is often more important than well-drafted statements of policy and rules of behaviour. Such supportive environment activates entrepreneurship.

Example 2

In an IT-based organization, CMC Ltd, the top management, headed by Dr P.P. Gupta before the company was sold by the government to private owners, had laid down values such as respect for people, trust of people, opportunity for growth and development and facilitation for innovation. The organization evolved practices which were derived from their value system. They had no leave rules. An employee stayed away when he had some compelling need to be away on personal account. Each individual had responsibility for results. The employees did not have to submit their travel account to their superiors. They would sign the statement and the account was settled. The superiors did not have to continuously chase work; the employees could consult anyone if they needed help. Everyone sat in an open hall and could be approached without the formality of an appointment. In our study of the Corporation, we found that absenteeism was the lowest in CMC as compared to its contemporaries. No fudging of travel accounts was noticed. Everyone kept to their work schedules and observed quality norms. There was a meditation room where employees could go at their own discretion. CMC developed many new systems, achieved impressive growth and became known for innovation (Sehgal 1996).

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In brief, the organizational support for entrepreneurial behaviour is characterized by organizational practices which convey (*i*) respect for the individual; (*ii*) acceptance of an individual as a person by the community and not only as a role-performer; (*iii*) interactions among people that generate new ideas and encourage experiment even if they fail in their effort; (*iv*) recognition by the community for innovation and tolerance for deviance in thinking and (*v*) reward for high standards of performance and quality. The supportive environment demands performance and quality but it also encourages processes that create a sense of belonging and acceptance among employees, and practices that encourage self-direction and control.

1.12 THE CURRENT SCENARIO

Vast majority of organizations are top-driven. They are either subject to bureaucratic functional or rule-bound systems, or subject to family directions and controls. Some of them who have experienced competitive pressures in their key product groups have superimposed 'schemes' to reward improvements, largely in the performance area.

They have initiated many different schemes. For example, National Thermal Power Corporation (NTPC) has schemes such as a 'best practices' reward and teamwork, leadership, training, etc. Bharat Heavy Electricals Limited (BHEL), Bharat Electronics Limited (BEL), Gas Authority of India Limited (GAIL) and several oil companies have injected different types of schemes. Tata Motors have brought in and encouraged innovations. Tata Iron and Steel Co. Limited (TISCO) has a very successful works committee organization and a suggestion scheme. These are only a few instances but the basic structure is that of standardization, direction and control, with an attendant system of rigidities.

There are a growing number of companies, initiated by technically qualified individuals, that have a somewhat flexible managerial orientation and provide elbow room for employees. Another useful trend is that individuals with professional or managerial qualifications branch off to set up enterprises after some work experience or on completion of their studies. With rare exceptions, organizations provide conditions that activate entrepreneurial behaviour among employees. Of course, individual initiatives are noticeable especially among professionals. This trend will grow as the economy expands and business opportunities become more varied.

Luchsinger and Bagby (1987) suggest that characteristics of an organization that promotes intrapreneurship are:

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- Focus on results and teamwork
- Reward innovation and risk-taking
- Tolerate and learn from mistakes
- Remain flexible and change-oriented.

1.13 CULTURAL ORIENTATION

Sociological and psychoanalytical studies of child rearing practices have identified certain characteristics that develop during the process of primary socialization. In a joint-family environment, the head of the family is accepted as the leader and decision maker. The role of an individual is fixed. The younger people are taken care of in every respect; they follow what is required of them. They are protected by the elders in the family and people who are close to the family. Many studies have repeatedly found that the socialization process induces dependence, a strong family attachment and affiliated needs (Chattopadhyay 1975).

The same patterns are reinforced in most school systems where conformity and obedience are rewarded. These patterns are further reinforced in tertiary education and work environments. There are notable exceptions with respect to the characteristics identified here. This pattern is slowly changing in the urban nuclear family environment and among families where both parents work. A recent study of the urban youth, however, shows that while affiliation needs are still strong, young children rely on their friends for nurturance rather than the parents (Singhal and Rao 2004).

1.14 THE IMPLICATIONS FOR ENTREPRENEURIAL ACTIVATION

Such cultural orientation has both positive and negative implications. The positive aspect is that individuals have the support of their families in whatever they undertake. Any failure of a project is condoned and accepted without the assigning of blame. In cases where individuals have a family business, they are absorbed in trading, or shops dealing with items of daily use. The family provides the training. These businesses are now being threatened by mega-stores, shopping complexes and professionally managed retail outlets. The negative feature of cultural orientation is that individuals have little opportunity to question and develop their self-identity. In my study of factors that contribute to effective leadership, I found that it was organizations that helped people develop self-identity, selfconfidence and

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judgement, rather than the family (Dayal 2004). Some of the best recognized institutions of higher learning are consciously initiating systems and practices that help students to assess their own capabilities. Hence, the most important sources of entrepreneurial development may be identified as:

- Family, which provides security against failure, thus enhancing the risk-taking propensity for individuals concerned.
- Organizations that empower and mould people to seek out entrepreneurial avenues, either within the organization or outside it.
- Institutions of higher learning, which encourage an atmosphere of questioning and development.

These are not by any means the exclusive sources of entrepreneurial development, but are, I believe, representative of a trend.

1.15 ENTREPRENEURSHIP CULTURE: THE INDIAN PERSPECTIVE

A recent survey published in *The Times of India* (ToI) describes the Indian youth as 'cool, confident and even a little complacent'. The Indian youth today, in marked contrast to his ilk of the pre-reforms generation, is not worrying about the future. Rather he is sanguine about his future. The survey found only 7 per cent of the Gen-X Indians worried about finding employment and a mere 5 per cent anxious about financial stability. These findings of the global market research company Synovate, through a survey conducted across eight countries during July 2005, may be significant pointers to what India may become in the next score or more years. Interestingly enough, the study found Indian youth to be very different from his/her Asian counterparts. It found nearly 19 per cent of young Asians expressing their worries about good jobs and 16 per cent about financial stability, a much a higher figure compared to India. While youth across the region want to be wealthy, successful and educated, they want to achieve this through a range of business choices. A good number want to venture into business ownership and information technology.

Another survey, a Times-CNN poll conducted by the market research firm TNS in the four metros, finds people rather confident that India is going to be a superpower in the next 25 years. Is there any relationship between the findings of the two surveys? Yes and no. Yes, if certain conditions are fulfilled and no if we fritter away the advantage as is our wont.

Ambitions and expectations may translate into results only if they are backed by systematic efforts. An ancient *Sanskrit shloka* (couplet) from the Indian book of knowledge *Akshayniti Sudhakar* sums this up very succinctly;

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'Udyamen hi sidhyanti karyani na manorathe, nahi suptasya singhasya pravishanti mukhe mrigah', which means that an objective can be achieved only by making efforts in an enterprising manner. Mere desire cannot help in achieving anything. Just as a lion has to hunt for deer in order to satisfy his hunger. The deer on its own does not come to the lion to be hunted. Incidentally, it is the *Sanskrit* word *udyam* that is the origin of *udyamita,* the Hindi equivalent of entrepreneurship. Contrary to popular belief, entrepreneurship as a means of economic growth and wealth creation was recognized in the past too. There are references to suggest the power of *udyamita* in ancient Indian literature, dating back to as early as the 6th century BC, in the *Jatak Tales*, the popular literature of that time.

In all ages, then, entrepreneurship has been regarded as an important determinant of wealth creation. It was trading in the ancient times, labour-dominated production in the medieval age, technology-enabled manufacturing in the modern times and services- and knowledge oriented in the post-modern era. The all-important question that needs to be answered then is why is *udyamita* or entrepreneurship not picking up in India at the pace that is required?

1.16 ENTREPRENEURSHIP AND ECONOMIC GROWTH

It has sometimes been suggested that entrepreneurship plays a crucial role in industrial development and many thinkers attribute the development of the West to entrepreneurship. In fact, the word entrepreneur was coined by French Economist J.B. Say more than 200 years ago. It was Joseph Schumpeter who, in the first half of the 20th century, assigned the crucial role of innovation to the entrepreneur in his theory of economic development. One school of thought is that economy is the effect for which the entrepreneurship is the cause.

Entrepreneurship is fuelled by a need for achievement and it is this need for achievement that is related to society's economic and business growth. McClelland's seminal work on achievement motivation gives ample evidence of the correlation between the need for achievement (N-ach) and economic growth.

It has been observed that if investigators find evidence of a strong achievement motivation in a particular society they may be able to make predictions about economic growth in that society. By studying the social motives revealed in a culture's popular literature (especially children's books) and relating them to its economic history, researchers found that a high N-ach correlates with various indices of economic growth, such as the consumption of electricity

These studies have shown that a high N-ach is exhibited before spurts in economic growth and thus, predicts them. The delayed relationship is diagrammatically illustrated in Fig. 1.2.

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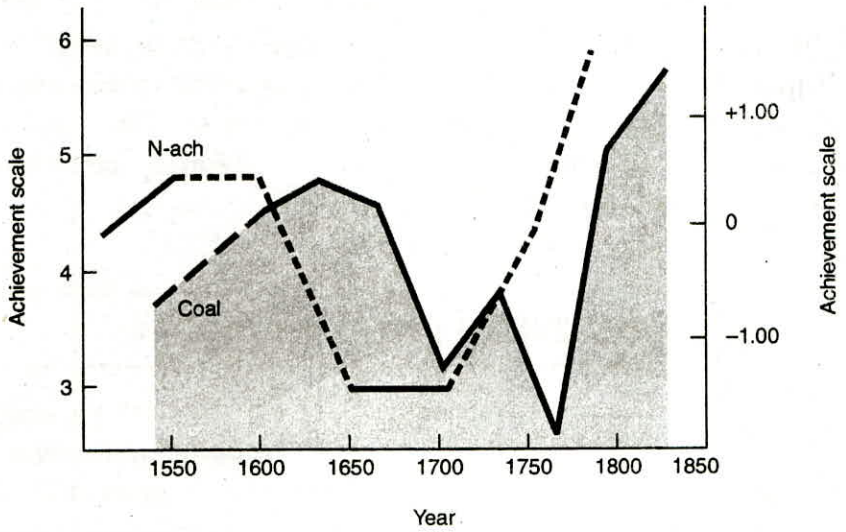

Fig. 1.2. *The Relationship between N-ach and Coal Imports in England between 1550 and 1850*

In Fig. 1.2, we see that the N-ach successfully predicted economic ups and downs in the English economy between the years 1550 and 1850. Economic activity was measured by changes in coal imports. The lag between levels of achievement motivation and economic changes was about 50 years. For the 20th century, investigators have found a shorter lag. Although the relationship between the N-ach and economic growth is suggestive, it is not proof that N-ach causes economic growth; they may both be caused by other factors. However, knowledge of social motives dominant in a society may help us understand its history and predict its future. This application of psychology to history and future trends is relatively new, but it may turn out to be a major contribution.

In light of this information, we can interpret the recent findings of Synovate and TNS studies quoted earlier as precursors to India's graduation from a developing to a developed economy. However, we need to keep our fingers crossed because there are reasons to believe that achievement motivation can only be translated into achievement oriented behaviour if certain other conditions are fulfilled, otherwise frustration creeps in. Furthermore, the outcome of achievement oriented behaviour is also dependent on other antecedent conditions.

Nevertheless, the fact remains that achievement motivation is critical to economic growth and development and is a necessary condition. Entrepreneurship by its very nature concerns activities and actions on the part of the people to create new ventures. It is essentially a way of thinking,

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a mindset. Of late, entrepreneurship is being treated as central to the economic development process and is receiving much attention from researchers and policy makers. In common parlance, entrepreneurship is often taken as synonymous with self-employment or creation of new firms or sometimes with innovative start up. However, the modern concept is that it is a much broader term and there are many facets to the modern entrepreneurial process, which facilitate, steer and shape the development of national and regional economies. Thus, for the policy maker these provide many opportunities to tap the benefits of entrepreneurship.

1.17 CULTURE AND ENTREPRENEURSHIP

The famous study on culture's consequences by Geert Hofsted has long proved that there are culture-dependent differences in thinking and acting, and at times this cultural differentiation may prove the crucial element in fostering entrepreneurship. Culture both reflects the environment—physical and social—and in turn shapes it. It is important therefore to understand the relationship between culture and entrepreneurship. The cultural moulding of one's perception, memory and attitudes indicates the massive impact of different designs for living upon the individual. A convenient shorthand way of referring to the training in the life-ways of a society, which the new member acquires through social interaction, is to speak of the 'effect of culture upon the individual'. But in so speaking, we are merely using a convenient abstraction to point to the myriad ways in which various people (who themselves learn the ways of the group from others) train the new individual in the approved ways. There is no single thing called 'culture' which influences a person. The relationship between culture and the individual is intertwined. Culture influences a person in a massive and pervasive way and this makes for the stability of a society and the continuity of its culture; the person also influences his culture and thus makes social change possible. The culture of a society consists, in part, of a particular set of arrangements for solving the problems of the members of the society. Some of these problems are special ones peculiar to the members of a particular society. Others are universal problems common to all human beings—such as meeting biological needs of the members, training the young, caring for the sick. There are, of course, many different possible arrangements for solving these problems. From among these possible arrangements, one society adopts one set; a second society, a different set. This is another way of saying that no two cultures are identical.

The particular set of cultural arrangements adopted by a society is influenced by the physical environmental factor, as well as man's attitude and desire to improve his habitat. A society's culture, in other words, is not entirely

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determined by the 'given' physical environment. Man is not a passive victim of his physical environment. Within limits, he can act on it and transform it to suit his ends.

The historically important thing with regard to natural resources is man's attitude towards them. It was not the availability of iron that created the Iron Age in Britain, nor the presence of coal that ushered in the Industrial Revolution, but the initiative of certain men at particular moments in time in finding a use for these mineral riches of the earth. The modifications or changes that have taken place in mechanical contrivances follow and tangibly employ prior modifications and changes in the purposes of human tool makers and tool users. The conversion of an agricultural parish in England into an industrialized community, the adoption of a new tool, or the incorporation of a new technique of production into a small, local cultural system has occurred early or late in time, here or there in space, as dictated by human will. Human geography demands as much knowledge of human beings as of geography.

The culture of a given society is also influenced by contacts with other cultural groups. Just as there is congruence between the 'physical surround' and culture, so is there congruence between the 'social surround' neighbouring cultures and the culture of any given society. The borrowings of one society from the culture of another are not, however, blind and random scavenging of odd bits and pieces. A society borrows only those cultural ways that are seen by its members as helpful in solving the problems they face; that are seen, in other words, as a means of reaching their goals. However, the impact of social surround is a slow and complex process that is determined, among other things, by strength of the cultures, the value system and the attitude of people towards change. Education plays an important role in determining attitudes. Perhaps, this is the reason why providing education for all is a central pillar of the Millennium Development Goals stipulated by the United Nations. The relationship between quality education and economic growth is now a proven fact. A few cases provided hereafter may be relevant at this stage. The Chotanagpur region of the Jharkhand state, which was earlier the southern part of the erstwhile Bihar state was one of the first regions to have acquired industrial status in independent India. The mineral-rich region had attracted the attention of our first Prime Minister Pt Jawaharlal Nehru and a number of large industries came up in the region. Along with large public/private sector undertakings like HEC, SAIL, IISCO, HSCL, FCI, PDIL, TISCO, the central as well as state governments promoted growth of small-scale industries and entrepreneurs were encouraged to set up units. With the nationalization of coal mines in the early 1970s this process gained further impetus. Thus, four major industrial area development authorities were created around the four industrial cities of Ranchi, Jamshedpur, Bokaro and Dhanbad. These were Ranchi Industrial Area Development Authority,

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Adityapur Industrial Area Development Authority, Bokaro Industrial Area Development Authority and New Kandra Industrial Estate, respectively. The objectives of these area development authorities were manifold. The state government wanted to enhance the pace of industrialization, exploit the natural resources of the region judiciously and catalyze economic growth and regional development. Many small-scale units were set up in the region. Some were ancillaries to the existing large industries and some were set up to use the natural resources, particularly coal and other minerals available as raw material. This period saw rapid industrial activity in the region. It is to be remembered that today's highly developed industrial regions like Gurgaon and NOIDA were not even planned then.

In the 1980s, the Government of Uttar Pradesh (UP) decided to develop the industrially backward eastern region, and a number of strategic initiatives like incentives to set up units in zero industrial areas were announced. Land, finance, etc. were made available and industrial estates around industrially backward districts like Varanasi and Jaunpur were developed. Thus, Ramnagar Industrial Estate in Varanasi District and Satharia Industrial Development Authority in Jaunpur were created. Many units came up. It was much later that NOIDA started coming up, after the government of UP decided to use the proximity of the region to Delhi as a strategic advantage. The Haryana Government's plan of developing Gurgaon came even later. However, as things stand today, the industrial area development authorities of Jharkhand and industrial estates of eastern UP are in shambles, while Gurgaon has become a leading industrial hub of the country, overtaking even NOIDA. A systematic observation of the industrial development process in and around the regions mentioned above will suggest that for entrepreneurship to flourish mere government support in terms of incentives is not enough. Nor, also, is the abundance of natural resources in the region. There is an entrepreneurial culture that is needed which includes many more things. It was this that was missing in eastern UP and Jharkhand.

Why the attempts to industrialize Jharkhand and eastern UP failed and why NOIDA and Gurgaon grew has to be understood. The difference lies in the cultures of these regions. While Jharkhand and eastern UP represent stifling cultures, NOIDA and Gurgaon represent facilitative cultures.

In stifling cultures, entrepreneurs set up units to misuse the finances and other incentives that are offered, the political establishment is exploitative, the support system is rudimentary and the social system is indifferent. Thus, all the stakeholders lack commitment. And without commitment the result is what we saw, efforts and intentions do not yield results.

Attempts have been made by researchers to find out the basic elements of the entrepreneurial culture. While opinions vary and views are myriad, there is a wide agreement on the fact that entrepreneurship flourishes in some

societies much more than in others. In India, for instance, Sindhi, Marwari, Gujarati and Punjabi cultures have thrown up many more successful entrepreneurs than others. This, however, is not to rule out the growth of entrepreneurship in other cultures. Rather, it is to identify the elements of successful entrepreneurial cultures and inculcate them in other cultures. But this is easier said than done.

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There is a need to study and understand the entrepreneurial culture, identify the elements of cultures and inculcate them in other cultures.

1.18 DEVELOPING ENTREPRENEURIAL CULTURE

India can make rapid strides if entrepreneurship gets due importance in national economic policies. The growth of Japan, South Korea, Singapore and other leading Asian economies can largely be attributed to entrepreneurship. The point to be noted here is that a culture for facilitating entrepreneurship is to be fostered. How to do this is perhaps to be learned from those who have realized it. Culture, like personality, has both content and pattern. Just as mere testing of the separate traits of an individual does not describe his personality, so the mere listing of the separate institutionalized ways of a society does not describe its culture. Two cultures, just as two personalities, may contain highly similar elements and yet be extremely unlike one another in pattern. It is this pattern, the arrangement of elements, that is critical. Just as in diamond and coal, the basic element carbon is same but the arrangement of molecules does the trick.

Developing entrepreneurship is thus a difficult task given the fact that you need a facilitative culture. Industries fail to flourish in Jharkhand, Bihar and eastern UP despite government efforts. The entire set of social, psychological, political, legal and economic environment needs to be taken into account. Delineating areas, outlining policies and announcing incentives may not be enough as has been proved in the cases mentioned above. A culture needs to be created. There is need to learn from the experiences and experiments of other cultures.

In India, the problem is diversity. There is so much diversity that a one-size-fits-all intervention will not work. Down south, the knowledge-based industry and its servicing has thrown up many entrepreneurs. Chennai and Hyderabad have seen rapid growth. East on the other hand is sluggish; rather the growth in Bihar, Jharkhand and eastern UP is negative, West Bengal being no better. Jharkhand is a classic case to prove how absence of entrepreneurial culture stifles growth. The state has abundance of natural resources, an industrial background running back to late sixties and availability of finances, yet it is ranked amongst the worst states in the country. In fact, the

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honourable High Court of the state has been constrained to observe time and again that Jharkhand is going the Bihar way. These remarks made by a highly responsible agency of the state sum up the quality of governance of the state. This quality, incidentally, is a crucial determinant of an entrepreneurial culture because other determinants like infrastructure and law and order are dependent on it. Another important aspect is the social-cultural milieu. But more than their presence it is their interaction that is critical.

What makes an economy tick? This, perhaps, is the most relevant economic question for us in present times. Particularly, because many in India see this country emerging as an economic superpower in the next few decades. The popular one word answer to this vital question should be entrepreneurship. Both the theory and evidence suggest that entrepreneurial activities play a pivotal role in economic growth, small and medium enterprises being the crucial determinants. It is precisely because of this that the Government of India as well as different states are so keen to encourage entrepreneurship. In fact, the various state governments are boasting about their open arm policy towards entrepreneurs. Finances are available, policy measures are initiated and technical support is being extended. Despite these, however, growth of entrepreneurship is not satisfactory. But why does the entrepreneurship that steered growth in the West, Association of Southeast Asian Nations (ASEAN) countries and Japan fail to click in India. Small and medium enterprises have not shown the competitiveness and the character that boosts the economic development. The reason in one simple word is culture— entrepreneurial culture. This has to be systematically developed.

The Jharkhand example sums this up very well. This new state has the potential to be a leading state of the country. But it is a laggard. The same can be said of Bihar and eastern UP. To develop entrepreneurial culture, policy initiatives have to take a culture-specific view. What works in one region may not necessarily work in another region. A holistic approach is required for developing an entrepreneurial culture, where the society at large is involved in entrepreneurial development. It is the social environment that ignites young minds towards achievement orientation.

1.19 SUMMARY

- The word 'entrepreneur' is derived from French word 'Entreprendre' which was used to designate an organizer of musical or other entertainments.
- Entrepreneur is a person of telescopic faculty drive and talent who perceives business opportunities and promptly seizes them for exploitation.
- An Entrepreneur has to perform a number of functions right from the generation of idea up to the establishment of an enterprise.

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- Market research is the systematic collection of data regarding the product which the Entrepreneur wants to manufacture.
- Entrepreneur has to develop schedule and action plan for the implementation of the project.
- Entrepreneur in industry, service and business sectors which are technically called as ISB sectors.
- The concept of entrepreneurship has been a subject of much debate and is defined differently by different authors.
- The word entrepreneur entered economic theory more than two centuries ago when a French banker, Cantillon, used this word to signify an undertaker of business.
- The issue of risk is central to the study of entrepreneurial behaviour and performance.
- The particular set of cultural arrangements adopted by a society is influenced by the physical environmental factor, as well as man's attitude and desire to improve his habitat.
- The culture of a given society is also influenced by contacts with other cultural groups.
- India can make rapid strides if entrepreneurship gets due importance in national economic policies.

1.20 REVIEW QUESTIONS

1. Explain in brief the concept of entrepreneur.
2. Give various definitions of entrepreneur.
3. Enumerate the characteristics of entrepreneur.
4. Distinguish between entrepreneur and manager.
5. Write a note on technical entrepreneur.
6. What are the rewards and penalties for entrepreneurs?
7. Explain in brief the functions of entrepreneur.
8. Explain in brief classification of entrepreneurs.
9. Explain in brief the concept of entrepreneurship.
10. Explain in brief the evolution of concept of entrepreneurship in India.
11. Explain in brief the role of entrepreneurship in economic development.
12. Explain in brief the stages in entrepreneurial process.
13. Write a note on barriers of entrepreneurship.
14. What do you understand by entrepreneur?

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15. What are the conditions that facilitate entrepreneurship?
16. What are the different characteristics of an organization that promotes intrapreneurship?
17. Correlate entrepreneurship and economic growth.
18. Write the short notes on entrepreneurship culture.

1.21 FURTHER READINGS

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UNIT 2 CREATIVITY AND ENTREPRENEURSHIP PLAN

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★ STRUCTURE ★

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2.0 LEARNING OBJECTIVES

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

- explain screening and project identification.
- define what is creative performance?
- describe the feasibility analysis.
- differentiate between monitoring and control segmentation.
- discuss about the creative problem solving.

2.1 INTRODUCTION

Innovation is the process by which the opportunities that have been identified through individual and organizational creativity are exploited. We have emphasized earlier that innovation and entrepreneurship must co-exist for individuals and organizations to be considered to be enterprising. Innovation is an essential element in enterprise by creating new business activity, in generating growth and ensuring survival for an existing business.

It seems quite natural for organizations to want to do things better and differently in order to gain a competitive edge over competitors and, in most organizations (albeit to different degrees) there is the ambition to seek out and exploit new opportunities with the aim of improving overall performance throughout the business. However, it must be remembered that innovation does not occur spontaneously. Organizational innovation is driven by creative and enterprising individuals.

In this chapter, therefore, we begin by discussing the nature and role of innovation, its impact in different types of organizations and the benefits it creates for a wide range of stakeholders. For example, the recipients of the organization's offering, its customers, consumers, clients, etc., expect to receive periodic improvements in the benefits they obtain. The organization must address this expectation through a comprehensive range of developments throughout the functions of the business. While the organization might have good intentions and aim to develop many new, successful ideas in practice, there are many challenges to overcome before a new idea becomes commercially successful and so we address some reasons for the failure of innovation.

Innovation is best coordinated through an effectively managed process and we discuss how this can be used to achieve efficient control and continual improvement through learning good practice from the organization's collective experiences. Innovation takes many forms and we particularly distinguish between the major-step-change innovations that generate considerable improvement in the added value for the various stakeholders of the

organization by doing things differently, and the smaller-scale incremental developments that are concerned with doing better what is already being done. Finally, we consider the alternative competitive stances that organizations might adopt and the implementation strategies that might be used to realize their objectives.

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2.2 CREATIVE PERFORMANCE

It is appropriate to begin the discussion with some comments on definitions of innovation and creativity.

Innovation and Creativity

Many definitions of **innovation** have been offered and some examples are given in Fig. 2.1. From reading through many definitions it is clear that choosing an appropriate definition of innovation seems to depend on the perspective being taken. Given the approach of this textbook to take a broad view of enterprise we favour an inclusive definition of innovation, embracing the exploitation of ideas in profit and non-profit organizations.

Creativity also has many different definitions depending on the context. For our purposes we consider it to be the generation of ideas, usually as a result of individual or small-team endeavour which will add value for organizations and/or their stakeholders. The ideas may not even be new but could simply be applied to a new situation.

Within the heading of innovations we take a market-based perspective of innovation that underpins entrepreneurship:

- Invention is not essential. The popular misconception is that innovation is the same as invention but the common view of writers in the field is that innovation does not necessarily involve invention. Indeed, Bolton and Thompson (2003), in the 'envision' stage of their entrepreneur process model note that the inventor need not be the opportunity spotter, nor the project champion who takes the idea forward to commercialization.

> Innovation is the successful exploitation of new ideas (innovation Unit, Department of Trade and Industry UK, 2004)
>
> Innovation is the specific tool of entrepreneurs, the means by which they exploit change as an opportunity for a different business or service. It is capable of being presented as a discipline, capable of being learned, capable of being practised (Drucker, 1985)
>
> Companies achieve competitive advantage through acts of innovation. They approach innovation in its broadest sense including both new technologies and new ways of doing things (Porter, 1990)
>
> Turning opportunity into ideas and putting these into widely used practice (Tidd, Bessant and Pavitt, 2005: 66)

Fig. 2.1. *Some definitions of innovation*

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- It is not just about having ideas. Many people have ideas but do not have the desire, the vision and/or the know-how to be able to commercialize them.
- Every function of the organization can contribute to innovation by adding value for stakeholders.
- Technology and non-technological developments are included.
- Both step change and incremental improvements are valuable in improving organizational performance.

Wickham (2004) points out that it is the opportunity that is ultimately most important, not the innovation itself. While our emphasis is on the entrepreneur or the innovator that profitably exploits the ideas, it is difficult to conceive of innovation without some creative input, whether that is in inventing a new product or in seeing new and better ways of doing things. By profitable exploitation, we do not only mean making money. In the public sector it can mean designing a new initiative, or finding a more economical way of delivering a service.

The UK, for example, has long recognized that it has a successful record of scientific and technological invention but is lagging behind in exploitation, innovation and setting up new businesses (DTI, 2003). According to the Global Entrepreneurship Monitor (GEM) Report 2000, the UK is lagging behind its competitors in certain respects. In particular, the level of new business start-ups is significantly behind countries such as the USA, Australia and Canada, and the entrepreneurial culture – particularly the tendency to identify and exploit business opportunities – is not well developed.

The UK government has sought to foster better links between research establishments, including universities, and industry in the hope of bringing more innovation to market (Innovation Report Online Update, DTI, UK, Feb 2005). They have also sought to forge partnerships between the public and the private sector, with the avowed intention of bringing greater commercial awareness to the delivery of public services, which could be described as innovation in process. In practice there has always been evidence of considerable creativity in the public sector, but this has been accelerated by best-value delivery and outsourcing programmes so common in the 1980s.

Adding Value through Innovation

Before discussing the various categories of innovation and processes in detail it is useful to consider how customers and organizations might benefit from innovation.

Customer Benefits from Innovation

If opportunities are successfully exploited, the recipients (consumers, customers, clients, etc.) of the organization's products, services, processes

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and ideas should receive additional value that will ultimately provide greater satisfaction than before, through the combination of tangible and intangible benefits that they receive from the new offering. Innovation might increase the ***tangible benefits*** of the product or service that appeal to the recipients' senses, in the form of better value; perhaps a product with a larger range of functions, better durability, or better design, is easier to use or is lower priced than the competition for a similar specification.

The ***intangible benefits*** take the form of a better designed or functioning product or service, efficient customer service, a better experience, and a feeling of greater satisfaction or enjoyment from the purchasing and usage process. The value of intangible benefits becomes obvious as products that appear to be physically the same may be perceived differently by customers if they carry a well known brand or are supplied by a company with a positive reputation. The customers may be prepared to pay a premium price or remain loyal to the supplier if they perceive that the brand offers extra intangible value. For example:

- a shirt made from the same material to the same specification in the same factory might be sold at a higher price if it carries a fashion label;
- customers are prepared to pay a higher price for a car with a VW badge rather than a Skoda badge, despite much of the engineering being to the same specification;
- Fairtrade products are differentiated from competitor products on the basis of using ethical business practices. It is difficult for individual consumers to assess the actual tangible benefits to farmers and so the appeal may be a 'feel good' factor for consumers who believe in the principles and trust the Fairtrade brand to deliver them.

Increasingly, other aspects of the purchasing and usage process are assessed and valued by customers, including the disposal of the item after it is no longer useful. For them there are many other improved benefits that an organization can offer: for example, by providing an effective service for customers that solves problems, removes 'hassle' from their lives, and offers greater convenience and accessibility, a 'fun' experience or simply the pleasure of being served by caring, interested and helpful staff. While on the face of it offering high levels of service may not seem as innovative as a technological product innovation it still requires creative management and delivery and the impact is equally important and often more difficult to achieve consistently in practice. For example, the success of many high-tech products is just as dependent on creative branding, distribution or advertising as it is upon the features of the product.

Providing these benefits requires the organization to configure its business model in a way that delivers them more effectively and efficiently than can

the competitors. This requires establishing strong links across a range of functions. For example, it does not only require financial resources for R&D, but it needs appropriately skilled staff to be recruited and trained, it needs marketing to analyse changing customer needs and it needs operations to deliver efficiently.

Organization Benefits from Innovation

Success for most organizations is determined by the degree of customer satisfaction that is delivered, but clearly this must not be 'at any cost' and so central to innovation is the concept of exchange and providing customer benefits in a way that the supplier organization can sustain.

In a private sector business the benefit for the owners of the organization might be in the form of increased wealth, which comes from the development of more profitable products and more efficient use of assets. For public or not-for-profit organizations the benefit will be in the form of being more effective (securing more impact for the same investment) or more efficient deployment of resources (lowering the cost of delivery without lowering quality or reducing outputs). For example, in an NHS Trust, innovation in systems might lead to more patients being treated per hospital bed. In healthcare, innovations are frequently at the public–private sector interface, where innovations are often the result of cooperation between individuals from public and private sector organizations.

Other stakeholders, such as the community at large, can benefit from an organization's innovation. For example, there would be community benefits from an organization developing a novel energy-saving policy. While the policy might also help to improve the organization's image and reputation among its consumers it may not necessarily reduce energy costs or otherwise improve product performance.

The Alternative Categories of Innovation

Accepting the broader view of innovation that covers the dimensions of invention – technological and non-technological, and step change and incremental innovation, we now turn to the alternative categorizations of innovation that have been proposed. The starting point is the four categories (the 4 Ps of innovation) identified by Utterback (1994), which describe the space in which the innovation takes place.

Product Innovation: changes in the products and services the organization offers; for example, M&S sell a small portion of pre-prepared Brussels sprouts in a microwaveable bag.

Process Innovation: changes in the way products and services are created and delivered; for example, online banking and betting.

Position Innovation: changes in the context in which products and services are introduced. For example, it was originally thought that older people would want to buy cars specially designed for easy access, economy, and high levels of safety, and with equipment to cope with increasing disability. In practice an increasing number of older people appear to be buying high performance sports cars to relive their youth!

Paradigm innovation: Changes in the underlying mental models which frame what the organization does an alternative characterization of new products was proposed by Booz, Allen and Hamilton (1982) who suggested that the key criteria were newness of the product to the company and newness of the product to the marketplace. Based upon research in the 1980s in the USA they concluded that the prevalence of products in the categories was as shown in Fig. 2.2.

- New-to-the-world products that create a totally new market; 10 per cent
- New product lines that enable the company to complete in a new product category; 20 per cent
- Additions to existing product lines; 26 per cent
- improvements and revisions to existing products; 26 per cent
- Repositionings of existing products to appeal to a new customer segment; 7 per cent
- Cost reductions to provide similar performance at lower cost; 11 per cent

Source: Booz, Allen and Hamilton (1982)

Fig. 2.2. *Categories of new products*

2.3 FEASIBILITY ANALYSIS

Technology is not an essential element of innovation but it often plays a key role in facilitating change. Tidd, Bessant and Pavitt (2005) explain that the eighteenth-century economist Joseph Schumpeter suggested that entrepreneurs use technological innovation to get strategic advantage and for a while this allows them to make a lot of money (monopoly profits). This step change or discontinuous innovation, according to Schumpeter, involves creative destruction. Step change innovation can be thought of as doing things differently. It usually follows a period of market stability and the innovation will cause substantial disruption.

There is likely to be considerably greater uncertainty and unpredictability in the technical success, customer acceptance and competitor response. However, other entrepreneurs will imitate this and, as a result, other innovations (incremental innovations) will emerge, resulting in many new ideas that chip away at the 'monopoly profits' until equilibrium is reached and the process starts all over again.

Technological Discontinuities

Foster (1986) illustrated the 'S' curve of the technology life cycle, as shown in Fig. 2.3. This plots investment in product development and performance improvement perceived by the customer.

Investment in product, service and process development results in a stream of small performance improvements that add customer value. However, at the top of the 'S' curve, when the mature phase of the life cycle has been reached, even for quite large research and development investment made there is little further improvement in performance. For example, analogue TVs reached this point and even substantial additional investment could not

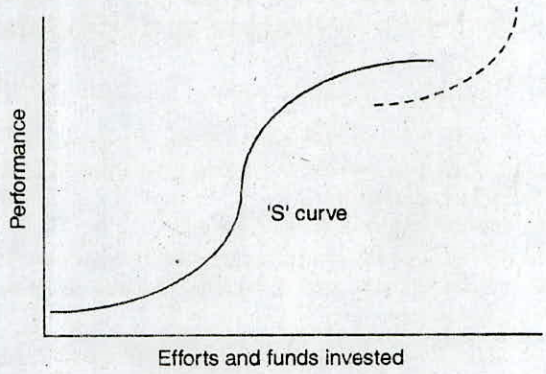

Fig. 2.3. *R&D effort and discontinuity*

achieve further small improvements in customer satisfaction. As digital TVs have become affordable, so the demand for the old products has declined quickly. This pattern follows a similar breakpoint and progression from black and white to colour televisions. You might speculate what the next breakpoint could be; for example, it might be a totally new level of interactivity or 3D imagery.

The Vicious Circle of Technology Evolution

Technology evolution drives change within an industry sector but also provides the means for entrepreneurs to respond to change and build competitive advantage, as shown in Fig. 2.4. Entrepreneurs are able to adapt and apply 'pure' science and technological inventions to create new commercial solutions in the form of new products, services and processes.

The entrepreneurial organizations that successfully embrace a new technology and find a practical application, for example, by creating a new product, service or a new route to market will gain a new source of competitive advantage. This usually results in new standards being set for the industry sector and leads to competitors having also to meet these standards if they wish to compete in the market in the future. All competitors in the sector

then embrace the new technology. Consequently, the innovator firms have to find a new innovation or technological advance that allows them to get ahead of the competition again. This cycle of technological development in the sector leads to creative new ideas, not just in the products and services of the 'for profits' sector. For example, it is just as important for a charity to use the latest communications methods to compete in fund-raising.

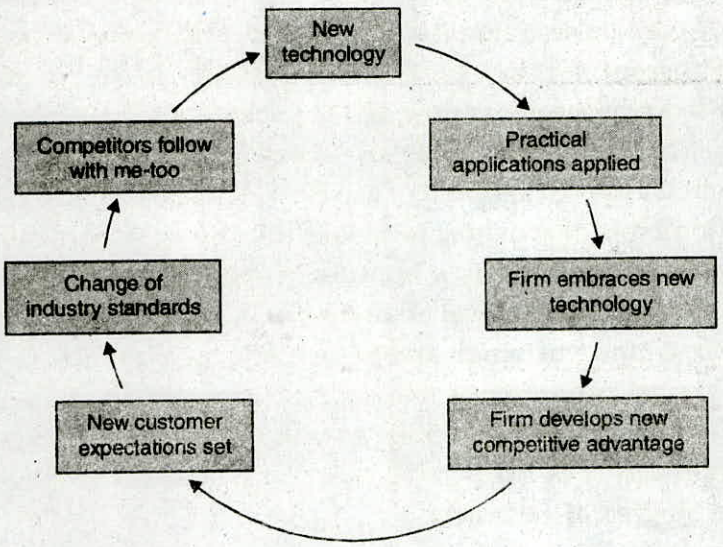

Fig. 2.4. *Technology and competitive advantage*

Incremental and Architectural Innovation

So far our discussion has focused on step change innovation, driven by technology but, as we said earlier, innovation is more broadly based.

Step Change Innovation

Step change innovation occurs not just because of technology changes but as a result of groundbreaking, creative ideas throughout the organization.

Incremental Innovation

Incremental innovation covers all the small-scale improvements that occur on a daily basis throughout the organization. Toyota, for example, has claimed that its quality improvement programmes generated over 60,000 improvements in one year.

Incremental innovation also involves considering all the technological alternatives and in necessity invention old technology can be applied to solve current problems, sometimes being integrated with new technology too.

Architectural Innovation

Tushman and Anderson explain that **architectural innovation** are the changes in the subsystems and linking mechanisms that are necessary to obtain the best benefit from minor technological changes. Honda adjusted its

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business model to market small motorcycles by selling through bicycle shops in the USA rather than motorcycle dealerships. In the 1990s IBM failed to respond to the implications of disk drive technology moving from use in mainframe computers to PCs. Competitors were faster at seeing the opportunity, made the architectural change to their businesses and took a high market share, with the result that IBM suffered considerable losses. Tushman and Anderson suggest that the best firms are 'ambidextrous' and can effectively manage incremental innovation, architectural innovation and technological discontinuities. They are continually learning and acquiring detailed knowledge of specific technologies, markets, customers or competitors, reflecting on the combined areas of knowledge, re-evaluating the new knowledge against the background of the current situation and reformulating the organization's mix of activities to exploit the new opportunities. Innovation can therefore be understood as a knowledge-based process. For small-scale incremental innovations the level of uncertainty, for example, in the expected technical success and customer acceptance of the new offer is likely to be low. Step change innovations involve greater uncertainty but if the organization has experience, expertise, a track record of innovation and adopts a learning approach, it is likely to be able to predict the outcome of projects with a higher degree of certainty.

2.4 ECONOMIC, MARKETING, FINANCIAL AND TECHNICAL ANALYSIS

It is easy for entrepreneurial organizations to fall into the trap of assuming that the benefits of new innovative products and services, which are so obvious to the innovator, will also be obvious to customers. However, customers are rarely as involved or as interested in the new product or service introduction as is the innovator. They may be still relatively happy with the existing product and see no real reason to change and would not be prepared to go out of their way to do so. Rarely do customers form a queue at the door to buy unproven products or services! Innovations change the pattern of customer buying and usage and even when the benefits, improvements and additional customer value appear to be obvious, the supplier must still market and sell the product effectively. Equally, organizations can fall into the trap of believing that the organization is flexible and can easily accommodate new developments without disruption of operational efficiency. Alternatively, some believe that an innovation is superior and command a premium price and that these factors will offset inefficiencies in its operation.

Robertson (1967) identified three categories of innovations according to the disruption they cause to customers' buying and usage patterns and thus the

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amount of customer education and promotion that might be needed. The suggestion is that the more disruption, even if the result is greater benefit to customers, the more education and persuasion is needed. The problem is that providing high levels of customer education can be very expensive and sometimes beyond the means of some smaller organizations that have limited resources and limited capability in many business functions.

Continuous Innovations

Continuous innovations to the product require little change to the purchase and consumption behaviour in customers. For example, the introduction of fluoride in water, additives in food and new chemicals in fertilizers or the use of CFC-free refrigerants in refrigerators would appear to have no significant effect on the purchase process or use of the product at least so far as the consumer is concerned. Consumers are becoming more knowledgeable and demanding however and with pressure groups raising questions, they are more likely to question certain types of continuous innovations. The introduction of Genetically Modified (GM) foods has raised fears in consumers' minds and made them reluctant to purchase the products without greater proof of their safety.

Dynamically Continuous Innovations

Dynamically continuous innovations have a more disruptive effect on the way that the products and services are used. For example, the introduction of the DVD recorder required some changes in routine to ensure that it is used effectively but it operates in a very similar way to previous recording formats. If the innovation is dynamically continuous it can be difficult to explain to customers the advantages compared to existing products or services, especially if the price is much higher. Discontinuous innovations have a highly disruptive effect upon usage and purchasing patterns and these innovations require a high level of marketing to explain the benefits and to educate consumers about how the product should be used. Microwave ovens had a significant effect on customer lifestyles but it was necessary to explain to customers that the invention was safe; that there were convenience benefits; and that a change in cooking methodology was possible. MP3 players for music downloaded from the Internet have a more disruptive effect on purchasing and usage behaviour of customers as they require different customer skills and knowledge. The more disruptive the innovation is to customers' normal purchasing, consumption and disposal patterns the greater the investment that is needed to educate these customers in respect of why they need the innovation, how they will benefit from it and how they should use it (and not use it). In the early days of microwave ovens, for example, suppliers omitted to tell consumers that they were unsuitable for drying cats after they had been out in the rain, with disastrous consequences!

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Creative Destruction and the Internal Organizational Challenges

As well as posing new challenges for marketing, discontinuous innovations and slightly less so, dynamically continuous innovations, cause disruption to the internal operations of an organization. If the innovation is disruptive it might require a radical change in the firm's management processes such as manufacturing, distribution and marketing. It might even need a complete re-invention of the firm's business model and practices. One example of this is the introduction of digital photography which has not only had a huge effect on the major film and camera manufacturers but also on smaller organizations, including for example, those involved in film processing.

Disruptive Technology

Christensen (1997) introduced the concept of **disruptive technology**. In the 'S' curve the performance of a new technology is usually inferior to that of the old technology. Often, because the new technology appears to be creating a new market, it is not taken sufficiently seriously by the existing players in the established market. For example, the first mobile phones were cumbersome and performed much worse than fixed line phones. By the time the fixed line players started to become interested in the new market, the new entrepreneurial mobile phone suppliers were already strong competitors.

Christensen suggests that contrary to popular belief large firms are aware of new disruptive technologies but their customers are resistant to change and continue pressing for improvements in existing products and would react adversely to being offered a product that was based on a radical technological change.

Creative Destruction

As a result of these discontinuities industries are characterized by **creative destruction**, or waves of new firm creation and failures, often referred to as 'shake outs'. Less entrepreneurial organizations find it difficult to switch resources to new opportunities and, instead, continue to invest heavily in existing products, and become committed to and dependent on them, even when they are in decline. Baron and Shane (2005) point out that firms are reluctant to cannibalize sales and this would explain for example, why Barnes and Noble were slow to move into online book sales, losing out to Amazon. Because such firms have considerable assets tied to a particular process they may be reluctant to change to a new technology or process and unwilling to aggressively seek a replacement that might require huge investment in new development and marketing to support it. Tushman and Anderson (2004 : 39), contrary to the opinion that revolutions usually arise outwith an industry, suggest that at the point of discontinuity the leaders in an industry

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will only become the losers as a result of creative destruction if the innovation is competence destroying, wiping out their considerable investments in soon-to-be obsolete skills and technology and eliminating the barriers to entry. Baron and Shane (2005) explain that the newcomer should spot and prepare to exploit those opportunities that result from breakpoints when they are at an advantage and the established firms have no particular advantage. Dyson introduced new technology to create innovative household cleaning products, the low-cost airlines competed with major airlines and online retailers such as Amazon challenged traditional retailing processes. It is also important to reconfirm that at a breakpoint the bright idea, alone, does not lead automatically to commercial success. As we have seen, suppliers of a profitable existing product often defend the present, predictable revenue stream, rather than turn enthusiastically to a more risky, less predictable income stream from the replacement product. Even when they do introduce a new product, such organizations often introduce it without real commitment and fail to convince customers to change. By contrast a newcomer to the market is likely to be totally dependent on the sales of the new product and will be fully committed to its success. However, if the newcomer does not have the entrepreneurial, business and marketing skills and the necessary commercial relationships the introduction may not succeed. An example of a competence destroying innovation is given by Drucker (2001), who comments that none of the giants of the electronic industry, such as GE (USA), Siemens and Philips (Europe) and Toshiba (Japan), who rushed into computers in the 1950s, were successful. By contrast there are plenty of large firms that are innovative, such as Johnson & Johnson in healthcare and 3M in a variety of sectors. He comments that it is not about size but about attitude; it does not come naturally but must be worked at.

2.5 THE INNOVATION PROCESS

Over many years a number of researchers have studied innovation performance and concluded that the most successful organizations have developed innovation processes in order to address a number of challenges:

- the need for market and technological scanning to obtain early information about new opportunities and developments;
- the high cost and the need to manage finance and other resource issues;
- the uncertainty and unpredictability of the outcomes in trying to do things differently or better;
- the need to coordinate the contributions of various departments (such as research and development, operations, marketing and finance);
- the need to get the time of the launch of the new product right;

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- the need to plan to allow staff the time away from their day-today responsibilities and the scope to carry out developments.

The value of developing a process of innovation is that if it can be defined it can be used to overcome the commercial challenges by anticipating the potential problems, and managing and controlling the various contributions to the process. Moreover, by reflecting on the successes and failures, learning from the experience thereof and continually improving them, the success rates of the new developments will increase. In practice various models of the innovation process have been developed over the years and it is to this that we now turn.

2.6 TECHNOLOGY PUSH, MARKET PULL

An early concept in the evolution of the process drew a distinction between technology push and market pull as the different drivers of innovation.

Technology Push

Often, high-technology science- and engineering-based firms pursue scientific exploration unhampered by the consideration of specific customer and market requirements. For example, small bioscience companies carry out chemistry research in the expectation of eventually producing a chemical compound that might ultimately become a commercially exploitable drug. In the early stages of development the therapeutic outcomes and actual customer benefits cannot be precisely predicted.

Market Pull

In some organizations the innovation is focused solely on meeting carefully defined customer needs. For example, a company supplying supermarkets with own-label products relies on the supermarket to forecast consumer demand. It will carry out only the development work that is necessary to satisfy the needs of the supermarket, defined in terms of a precise product specification and maximum price it is prepared to pay. These stances might be considered to be at the opposite ends of a continuum. Most organizations adopt a stance in between these extremes and include elements of technology push and market pull. For example, in the past, pharmaceutical companies adopted the technology push stance but in more recent times they have increasingly focused on specific therapeutic areas in order to exploit a reputation for excellence in one area of therapy gained over time, for example, in cancer or antiulcer treatments.

Part of the reason for this is that with increasing competition a deeper understanding of patient need and response is required and more support

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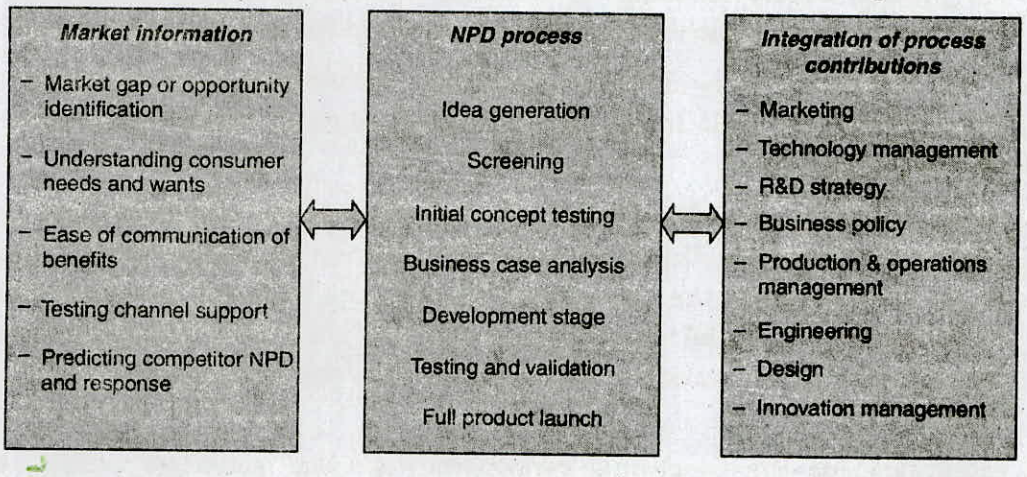
activity may need to be provided. For example, an innovative pharmaceutical product designed to combat obesity might perform satisfactorily only if patients are prepared to change their lifestyle. The success of the product for the company is therefore dependent on providing support programmes that will help to achieve this. Equally, suppliers of own-label products to supermarkets can increase the value of their offering by proposing technological innovations which might create a superior product to the branded product that is supposedly being 'copied'.

It can be argued that while the positions at the extremes of the continuum can provide a sustainable position for an organization they are potentially risky too. For example, unhampered exploration may never lead to a saleable product offer and meeting market needs may never allow the organization to create a competitive edge and charge premium prices.

2.7 THE INNOVATION MODELS

Booz, Allen and Hamilton (1982) produced the best known model of **new product development** (illustrated in Fig. 2.5) and this provides the basis for the evolution of the innovation process. There are a number of key features of this model:

- It involves a systematic, linear process involving a number of stages, with decision points at each stage.
- For each stage (*e.g.*, idea generation, setting criteria for screening, etc.), it is necessary to develop a set of operating principles and apply the appropriate tools and techniques for choosing the option to pursue.



Adapted from: Griffin (2003)

Fig. 2.5. *New product development process*

- It is desirable to undertake the lower-cost activities such as carrying out the concept and business analysis that involve staff time only and not

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additional resources, very early in the process, in order to eliminate likely failures as quickly as possible, so incurring low levels of unproductive expense. Failures late in the innovation process can be very expensive.

- Delay the most expensive activities, such as prototyping a product until there is a strong likelihood of commercialization.
- The model separates technology push and market pull in order to ensure that the customer demand is defined separately from the technological analysis.
- It is necessary to break up the overall process into a series of clearly defined tasks so that the activities, roles and responsibilities in the process can be managed and controlled.

There are, however, a number of problems that arise when implementing these basic models including:

- the problem of separation of activities along functional lines within the organization, as this often leads to conflict between, for example, research and development, marketing, operations and finance. A balance has to be struck between the benefits of functional specialization against cross-function synergy in solving problems;
- in more bureaucratic organizations the delays caused by the linear approach and the need for decisions at various stages – this can extend the time it takes to get the innovation to market with the danger that the launch might be delayed, so allowing competitors first-mover advantage;
- the process possibly being too cumbersome for incremental changes that are better managed and controlled with a 'light touch';
- the process overly focusing on internal activities and not adequately including external contributions from partners to the development process.

Rothwell (1992: 102) has identified the newer developments of the process which enhance the basic model by addressing some of these weaknesses. These models include:

- parallel activity, which addresses the problem of an extended time to market. For example, the screening of the alternative designs of the final product appearance, the concept testing and the business case analysis can progress in parallel with the preparation of the launch plan where an organization must launch a new product into the market at a specific time;
- integration of the functional responsibilities and activities – this is facilitated by setting up cross-function project teams to take joint responsibility for progressing the innovation;
- recognition of the role and specialist contributions of outside organizations,

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such as suppliers, customers and advisers (specialist design, research, marketing consultancies, etc.), and the collaborations with partners, who can contribute complementary skills and expertise;

- use of systems, particularly IT based, to facilitate the integration of the contributions, networking and information sharing and to support internal product and service concept evaluation.

2.8 PROBLEM IDENTIFICATION AND SOLUTION DEVELOPMENT

Having discussed the contexts in which entrepreneurship and innovation occur, we now turn to the practical steps of proactively identifying the opportunities that the entrepreneur or enterprising organization might pursue and discussing the various alternative solutions that might be developed to exploit them, such as new products, services, processes and ideas. In doing this we emphasize that while there might be good potential sources of opportunity that are generated by changes in the environment or through invention, it is only when customers are convinced about the benefits of the solution that they are offered that the opportunity might be considered to be viable as a business venture.

We emphasize that opportunity identification is not simply concerned with invention and the development of completely new products or services. The response to the opportunities that are identified might take the form of many small improvements in the processes used by an organization or throughout the whole supply chain. Alternatively, the response required might involve a completely new way of thinking about and exploiting a market.

We start off by discussing the sources of opportunities and how these might be identified and look at how, with the benefit of hindsight, this has been done in the past. We then go on to discuss the knowledge, market understanding and thinking processes that might be used to identify opportunities from breakthrough ideas through to more modest incremental improvements. True breakthrough opportunities challenge the assumptions, standards and values on which the sector has operated, by fundamentally changing the ways things are done. While it is often individuals or organizations that are outside the sector that develop the new ideas, it is possible for those working in the sector to more systematically analyse a particular situation in order to challenge their own assumptions about what customers might want.

In constructing an offer to exploit the opportunity it is necessary to recognize the nature of the possible business solutions that might be developed in terms of the combination of ideas, products, services, and business support processes that make up the complete package of benefits to customers in

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order to provide greater value than before. Once a number of opportunities and possible solutions have been identified successful innovators follow a systematic new product (or service) development process to decide which ideas are worth pursuing to the later stages of concept testing, prototyping, and market testing. However, to follow a systematic process can be very time consuming and potentially expensive and so, finally, we consider the ways in which entrepreneurial businesses can reduce the length of the development process.

2.9 THE IDENTIFICATION OF PROBLEM

The starting point in the commercialization process of ideas is identifying where a gap in the market might exist or where changes in the market might act as a catalyst for developing a new solution that customers will need. Muzyka (2000) explains that opportunities come in many ways, shapes and forms and entrepreneurs, while not needing to have the idea themselves must structure a business around the idea. In this chapter, therefore, we first consider some sources of innovation before discussing the drivers that might encourage entrepreneurs to create a new business.

2.10 CREATIVE PROBLEM SOLVING

Many opportunities for innovation and entrepreneurship come from applying technology or bringing new ideas into the functional areas of a business to create change within an established market. Two views about the **source of innovation** come from Ansoff and McDonnell (1990) and from Drucker (1985). Ansoff and McDonnell emphasized the effect of shock events on innovation. Opportunities for the organization and threats to the organization emerge from the environment and are not within the control of the organization. They suggested that shock events arrive suddenly, pose novel problems and raise the prospect of major business loss. Two examples of this are the effect of 9/11 on the airlines and of Napster and other pirate websites on the music recording industry. When faced with sudden and unexpected events the organizations that are more innovative than competitors in their response to the opportunities and threats are the ones more likely to succeed. Drucker (1985) identified the same factor but also suggested others such as:

- the unexpected event that triggers off a new demand (for example, interest in renewable forms of energy because of potential shortages or the high price of oil) or climatic effects (for example, demands for construction following the Asian tsunami and hurricanes);

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- an incongruity between what is available and what is needed by consumers (for example, the creation and growth of telephone and Internet banking);
- a process need to fulfil a major new demand by consumers (for example, security software for e-commerce);
- a change in the industry structure, for example the increased deregulation of financial markets leading to many new businesses, or in the energy and farming sector;
- a change in demographics (for example, the increasing number of elderly people in developed countries boosting demand for certain categories of new products);
- a change in the perception or mood of the community (for example, green marketing and interest in organically farmed foods); or
- the development of new knowledge (for example in bioscience leading to the growth in research into and promise of new products and in biotechnology regarding the development of personal identification for passports and identity cards).

2.11 LOOKING FOR OPPORTUNITIES IN THE MARKET

So far we have presented some conceptual and perhaps rational methods for looking for opportunities in the market. However, innovation does not necessarily follow rules and the way that entrepreneurs and enterprising organizations identify and develop opportunities is often very subjective and personal as well as objective and rational. Inevitably this means that entrepreneurs often see opportunities where others do not and view the opportunities differently from others. The opportunity for an entrepreneur might not be in a high profile product but in peripheral support activities, such as consultancy, software or training.

Mature Markets, Not Necessarily Growth Markets

Conventional wisdom might suggest that high-growth markets offer the best chance of success. Indeed, stock market analysts often pick 'winners' from these growth sectors, which are typically well-researched and documented in the business press and often overlook the new-starts and earlystage businesses that are growing steadily in more mature, less glamorous markets. These mature markets are usually dominated by well established suppliers, products and services. Competition is largely predictable, prices are often static and customer expectations and demand appear to change little.

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However, many of the examples that we have given in this book relate to innovation by entrepreneurs who bring new ideas to uninteresting markets, capture the customers' interest and subsequently achieve spectacular growth.

Seemingly Impossible Markets

The highest compliment that can be given to a salesperson is that 'he or she could sell sand in the desert or refrigerators at the North Pole' but there are in actuality many examples of entrepreneurial businesses exploiting opportunities that seem very unlikely. For example, a tiny UK soup manufacturer, New Covent Garden Soup Company, was able to develop a market in the USA for its soups made from fresh ingredients against fierce competition from the locally based multinational soup manufacturers.

Exploiting the Obvious

Frequently, potential entrepreneurs believe that an opportunity that is clear and obvious to them must be equally clear and obvious to many other individuals and organizations, but this is often not the case. The same opportunity is not always obvious to everyone and often, a simple idea can be introduced without immediate competition. Although not a major player in the ice cream market Grand Metropolitan developed an entrepreneurial business, Haagen Dazs, to offer a new, premiumpriced product using innovative marketing, including sexy advertising in glossy magazines and endorsements from celebrities to create an adult market for ice cream. Usually competitors in the UK, such as Walls, had traditionally produced largely children's and family oriented ice cream products and it was some time before they offered a competitive product.

Creating Customer Value

One of the rules that governs entrepreneurship is that innovations must create added value for the customers. Of course, **customer value** can be interpreted in many different ways and different organizations will create different value propositions to exploit the same market opportunity.

Offering Low-Cost Alternatives

In identifying opportunities, simply offering a lower-cost 'me-too' alternative to existing products or services is not considered to be a sustainable strategy, because of the likelihood of competitor reaction. A small business that undercuts the market is likely to attract a response from larger and more powerful competitors, who will be better resourced to win a price war. Low-price copies of most products and services will quickly become available from organizations from emerging markets and so threaten unsophisticated offers.

Being able to introduce a new product, service or process at a lower cost than

a current product from a competitor might win over customers, but it is not always necessary and in the longer term may not be as important as building in other dimensions of added customer value.

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Low-Price Products and Services, with 'No Frills'

Some low-cost businesses have secured a viable market position; value food retailers, such as Lidl, Aldi and Netto are examples of the exploitation of a market opportunity, in which a customer segment is seeking value in the form of basic products of acceptable quality at everyday low prices. Innovation in these organizations is focused on lowering the costs of supplies, reducing overheads and maximizing the impact of limited marketing.

Premium-Priced Value Added Products

In general new products that offer extra value for customers can carry a premium price. There are many examples of value added product introductions that were priced higher than the competitive products that they were aiming to replace. Dyson launched bagless vacuum cleaners at a price that carried a significant premium to its competitors. It was able to gain a high market share because of a product innovation for which customers were prepared to pay considerably more for real benefits. Users of mobile phones, too, have been prepared to pay more for the convenience that they offer over fixed-line telephones.

Finding a Unique Edge

Even if there is competition, exploitation of one of the elements of the total offering that is made to customers can provide a unique competitive edge. For example, Starbucks run coffee bars, which are part of what is essentially a commodity market. Although they have considerable competition they provide a differentiated product offer that is valued by customers, even though customers have to pay a relatively high price for a relatively basic service. It is important to focus on the customer needs, and Barrow *et al.* (2005: 143) suggest that it is important to concentrate on answering the question 'How can we make money for our customers rather than how can customers make money for us?'

2.12 SUBSEGMENTATION OF MARKETS

All through this section we have focused upon adding value as perceived by the customer. Therefore the most important element in the opportunity search is the identification of a market gap. Most of the innovations considered in this book fill a market gap. Because of the proliferation of products and

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competitors it is unlikely that a huge market opportunity will be obvious to an innovator as, today, most customer needs are filled, at least to some extent. However, by articulating customer needs precisely and understanding what customers really need or want, rather than what they will 'make do' with, it is possible to identify market gaps.

Subsegmentation is one example of filling a market gap. While the major market segments are served, customers in the subsegments of the market are not getting products and services that they consider to be ideal. Over the last 20 years the car market, which arguably was already mature, has been the subject of subsegmentation by carmakers. A whole range of niche products have been produced to address market gaps. These include the Renault Espace, Renault Megane, Range Rover and Smart Car. In a similar way Prêt á Manger and Underground have exploited the market opportunities for betterquality, yet still fast, sandwiches.

For those who are working and cannot book at surgeries during normal surgery hours but are prepared to pay, GPs have set up surgeries in supermarkets and other convenient locations, allowing patients to drop in.

Because markets generally are crowded with products and services the key to identifying the market gap is defining and explaining to customers exactly how the new offering meets their own specific needs and how the new product or service differs from the existing products. This process is called positioning and is dealt with in greater detail in the next section.

Sectors with Particular Potential for Entrepreneurs

A number of sectors that have low entry barriers and low set-up costs tend to be attractive ones for entrepreneurship. These include, for example, the leisure and tourism industries. Sectors evolve over time and pass through different phases in their attractiveness to entrepreneurs. Food retailing has gone through years of consolidation, with many corner shops going out of business as supermarkets and hypermarkets have proliferated. Now, however, a gradual backlash is appearing as customers become frustrated with bland food filled with additives and salt, often grown in unnatural conditions. Specialist highquality food manufacturers, retailers and farmers' markets seem to be expanding.

Organization Structure Opportunities

The business model adopted by a large organization or changes to its structure, can offer opportunities.

Franchising tends to be a relatively low risk and low cost entry option and offers the prospect of owner management without the entrepreneur having to come up with an idea and develop a business model to exploit it. Over 1000 franchise opportunities are listed at www.franchise.org. There are some

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clear benefits in starting a business through a franchise, for example, a proven business model, reliable suppliers and supporting promotion but there are also some disadvantages, such as the relative lack of independence, freedom to manage the franchise and scope for innovation on the part of the franchisee.

Subcontracting enables smaller suppliers to supply products and services to a major company to a defined specification at an agreed price. While the promise of regular orders can be attractive to the small supplier, the risk of supplying one or two customers only can be high.

Break up of an organization large organizations restructure their operations from time to time because of market changes, mergers and acquisitions and this provides opportunities for management buy-outs and management buy-ins.

Looking at What Others have Left Behind?

If a major organization decides to stop supplying a business sector there are often opportunities for small businesses to step in and supply established products that are no longer available. Quite often when large organizations downsize their operations they often continue to require the services that they used to supply themselves and obtain them by subcontracting to small suppliers.

Creativity and Thinking Techniques

We now turn to methods that might be used to generate ideas. Barrow *et al.* (2005) say that some weird ideas exist for managing creativity, commenting that, from their research, successful management practice can include opposites, such as:

- Find some people and make sure they don't fight, or . . . make sure they do fight!
- Think of some sound and practical things to do and do them or . . . find some ridiculous and impractical things to do!
- Take your past successes and replicate them or . . . forget them!
- Hire people you do need or . . . hire people you do not need!

Baron and Shane (2005 : 65) discuss the importance of intelligence in creativity and suggest that entrepreneurs need to balance three components to achieve successful intelligence: (1) creative intelligence to come up with new ideas, (2) practical intelligence to identify ways to develop these ideas and (3) analytical intelligence to evaluate the ideas and determine whether they are worth pursuing. They go on to explain, in taking a broader view suggested by Sternberg and Lubart (1995), that creativity emerges from the confluence of:

- intellectual abilities, relating to problem interpretation and persuasion skills to convince others of the new ideas;
- a broad and rich base of relevant knowledge;
- an appropriate style of thinking – novel thinking and escaping the 'rut';
- personality traits and the willingness to take risks and tolerate ambiguity;
- intrinsic, task-focused motivation so that creative people gain rewards from doing their work;
- a supportive environment that supports creative ideas.

Asking Customers or Potential Customers

Asking customers or potential customers about possible new product ideas is the most obvious route to generating ideas but it requires real understanding on the part of the innovator to interpret customer requirements.

The problem with asking customers for new product ideas is that they often, in the first instance, do not ask for a new product because they do not really know what is possible – therefore they cannot ask for it. They try to articulate their future requirements in terms of what is currently available, rather than what might be possible in the future. Some leading customers, especially if they are close to more 'blue sky research' thinking, are able to visualize the future and what products will be needed.

Considering Adjacent Markets

Here the objective is to consider whether an opportunity in one market might lead, with some modification, into another. For example, a more robust version of the mobile phone is necessary for use where it might be easily damaged, for example, in the construction industry. Equally, there is a market for short-term mobile phone hire. The technology used in home entertainment, such as video cameras and television monitors, is used for security applications.

Analysing Competitor Products

It is possible to learn a great deal by analysing competitor products as this might also provide opportunities for improvement. For example, the Japanese earthmoving equipment manufacturer Komatsu analysed the products of the US supplier Caterpillar, which was the market leader. Komatsu realized that many Caterpillar products were over-engineered and therefore unnecessarily expensive for the market it was targeting. Komatsu produced cheaper but soundly performing products for specific uses and gained considerable market share from Caterpillar.

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Analysing Customer Needs and Behaviour

Observations of customers using products and services together with an analysis of their buying motivations can reveal new insights into the ways customers respond to products. Provided they are willing to allocate sufficient time, individual entrepreneurs can gain similar insights and so help to avoid costly mistakes in the future. For example, observing customer traffic in a shopping centre or street can help in choosing an appropriate location for a retail outlet. Studying the hits on a website will provide considerable information about how the website should be configured to retain the interest of those visiting it.

Brainstorming

Brainstorming is a commonly used technique for idea generation but the results will not be as good as they might be if it is not carried out systematically. All suggestions or ideas should be allowed in brainstorming as they may be modified and eventually lead to workable ideas but, if there are no rules, crazy ideas are likely to be dismissed without proper discussion. Also, if the boss is present at a brainstorming session, it is necessary to ensure that he or she will not stop crazy ideas being suggested or inhibit other ideas being discussed in favour of their own. Brainstorming can be made more productive by setting some basic guidelines, such as initially listing all the ideas generated by the group of individuals without additional comment, then taking time to group ideas, build on them and ensure that even the most outrageous suggestions are considered in case there is anything of value that will build on the other ideas proposed.

Forced relationships

The objective here is to force together two existing concepts to create a new third product or service idea. The computer workstation combines a desk and a computer, an electric piano combines a traditional piano and electronic sound system and many combinations are available of a DVD recorder and television, radio and alarm clock.

Morphological Analysis

This is a technique designed to deal with a complex problem by breaking it down into a series of steps and then considering different ways of taking each step. It is effectively about a way of determining the different ways of getting from A to B.

Challenging Industry Assumptions

Firms in mature business sectors often become reactive, drawing in resources to respond to short-term competitive activities and have no time or resources to think about the sorts of products and services that are needed for the

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future. Without this creativity these firms fall back on imitating competitors, believing the competitors' actions to be right for the market, rather than really exploiting the changes taking place in their customers' needs and wants. Their innovations often become limited to small changes that result from benchmarking against competitors. Kim and Mabourgne (1997) explain that high-growth firms leave the competition to fight among themselves and instead, seek to offer customers a quantum leap in value. The question that should be posed is not what is needed to beat the competition but rather what is needed to win over the mass of customers. The implications of this are that it is necessary to challenge the conventional wisdom and assumptions of the industry about the basis on which firms compete and what customers value. An additional bonus from challenging the way the industry does things is that, if the firm thinks globally, this can also lead to large cost savings as unnecessary operations are cut out. If the benefits really lead to a step change in value they will be perceived as such by customers all round the world.

2.13 VALUE ANALYSIS

Having identified an opportunity we now turn to developing the idea, product, service or process that will provide the solution for customers.

Customer Benefits

The starting point is to consider what people actually buy. Customers buy benefits rather than product features. A new idea, product, service or process must provide something that customers need, want and will value. The benefits might be something that will save them time and hassle, entertain them, solve a problem or, perhaps, enhance their feeling of status among their friends.

However, many organizations and entrepreneurs erroneously believe that the secret to satisfying all their customers is to focus on packing a product with features, introducing a technologically advanced new product, service or process and including many (often rarely used) functions or unnecessarily intricate designs. The danger can be that entrepreneurs, designers, development managers and innovative organizations 'fall in love' with the technology and create the new product to demonstrate their superior technical knowledge and capability rather than work out and give exactly what the customer might want.

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Customer Segmentation

Many new products claim to be right for everyone. The problem with the 'one product fits all' approach is that it ignores the fact that, within a mass market, there are a number of groups of customers (segments) with some similar but also different requirements. As we have discussed earlier, an entrepreneurial organization might choose to target either the mass market or one segment, as a niche supplier, but whichever approach is adopted it must meet the customer's specific needs.

Usually, the key to ensuring a match between the offer and the benefits sought by customers is recognizing that different segments want different things. The approach is first to identify a number of groups of customers (segments) that have a similar need or expectation of the product. For a personal computer, this might include the technology 'geeks', small-business users, gamers, children using it for homework, and so on. The organization would choose the segments it wishes to target on the basis of its ability to service the segment better than its competitors.

To do this it then would have to profile the target segments by getting as much information as possible about their characteristics, beliefs, needs and lifestyles. It can then position its offer to be attractive to the target segment and different from the competitors' offers by innovating in various aspects of the total product offer to make it quite distinctive. Even if the benefits are obvious, many customers will still be reluctant to buy a new product or service, until they are convinced that they have a reason to buy it and it is a good use of their money, so the product offer must also have marketing support as we now explain.

Innovation Throughout the Total Offer

Over the years increased competition to provide a solution for an identified opportunity has led to a proliferation of products and services and increased choice for the customer. The aim for the majority of suppliers is to differentiate their product or service from that of their competitors through innovation in some aspect of the product or service, or the activities supporting it, in order to gain competitive advantage. For the remaining suppliers who wish to copy competitor products and services the challenge is how to use innovation to gain competitive advantage by reducing costs, so that profitability can be maintained even at lower prices.

The Total Product Offer and Areas for Innovation

Building upon these ideas it is useful to think of a product or service innovation not just in terms of creating new core product benefits to the

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customer but rather in terms of improving some or all of the elements of the product offer.

Kotler (1997) proposed a framework for the **total product offer**, as shown in Fig. 2.6. Each of the elements of the total product offer provides the opportunity for innovators to increase value by better meeting consumer needs and wants and this can be achieved through breakthrough or incremental improvements.

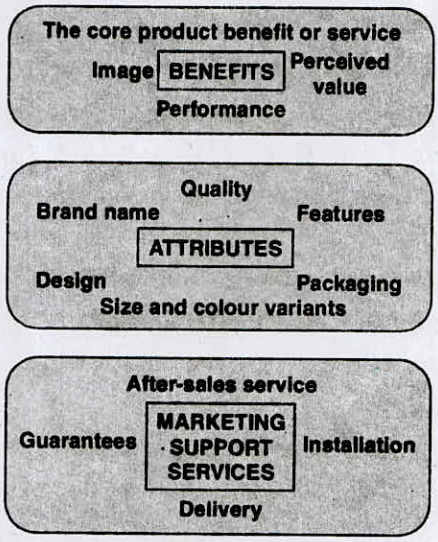

Fig. 2.6. *Three levels of product offer*

Goffin and Mitchell refer to work by Kano *et al.* (1996), who have explained how the features of a product affect customer satisfaction, categorizing them as:

basic features these are the core attributes, without which the product would be unacceptable; ***performance features*** these provide a real benefit to the customer, such as fuel economy in a car or battery life in a mobile phone; and ***excitement features or delighters*** these give unexpected value to the customer that seems out of proportion to the objective value, for example, remote controls for television operation.

In the model, product benefits are the elements that consumers perceive to meet their core needs and provide satisfaction through performance and image. Product attributes are the elements closely associated with the core product, such as features, specifications, design, branding and packaging, which provide reinforcement of the core product benefits. The marketing support services are the additional elements to the core product, which include delivery, after-sales service and guarantees. In commodity markets many of the core benefits of a product are similar, no matter which competitor provides the product. It therefore becomes necessary to differentiate the offering through innovation in one or more of the other elements of the total product offer.

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The core benefit of a motorcycle or a tee shirt is fairly obvious but you may wish to consider the ways that different suppliers differentiate the product by using innovations throughout the total product offer. As you will find, new products may include a single innovation or a combination of many. Having introduced the concept of the total product offer and the opportunity for innovation in every element, it is useful to consider the questions highlighted in Fig. 2.7.

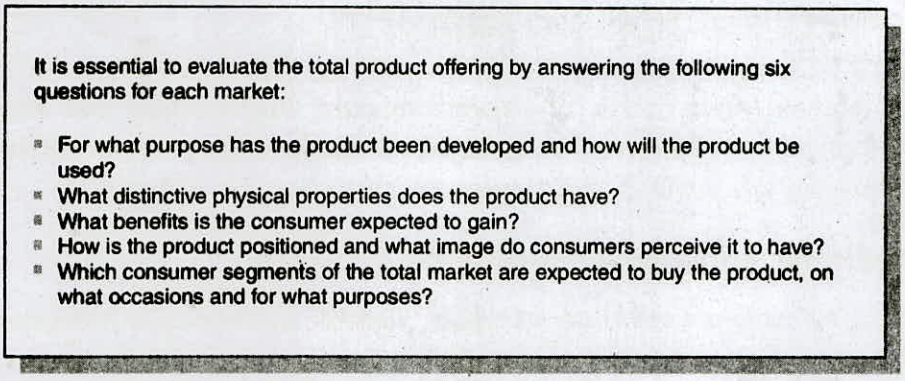

Fig. 2.7. *Product innovation opportunity checklist*

2.14 MEANING OF PROJECT

An entrepreneur takes numerous decisions to convert his business idea into a running concern. His/Her decision making process starts with project/product selection. The project selection is the first corner stone to be laid down in setting up an enterprise. The success or failure of an enterprise largely depends upon the project. The popular English proverb "well began is half done" applies to project selection also indicates the significant of good beginning.

The dictionary meaning of project is that is a scheme, design a proposal of something intended or devised to be achieved. Newman and his associates define that "a project has typically has a distinct mission that it is designed to achieve and clear termination point, the achievement of the mission. Gillinger defines project "as a whole complex of activities involved in using resources to gain benefits". According to Encyclopedia of management, "a project is an organized unit dedicated to the attainment of goal—the successful completion of a development project on time, within budget, in conformance with predetermined programme specifications." Now, a project can be defined as a scientifically evolved work plan devised to achieve a specific objective within a specified period of time. Project can differ in their size, nature of objectives, time duration and complexity. However projects partake of the following three basic attributes:

1. A course of action
2. Specific objectives and
3. Definite time perspectives.

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Every project has starting point, an end point with specific objectives.

2.15 PROJECT CLASSIFICATION

Project classification helps in expressing and highlighting the essential features of project. Different authorities have classified projects differently. The following are some of the important classification of projects.

Quantifiable and Non-Quantifiable Projects

Quantifiable projects are those in which possible quantitative assessment of benefits can be made. Non-quantifiable projects are those where such assessment is not possible. Projects concerned with industrial development, power generation, mineral development fall in the first category while projects involving health, education and defense fall in the second category.

Sectional Projects

Here the classification is based on various sectors like

- Agriculture and allied sector
- Irrigation and power sector
- Industry and mining sector
- Transport and communication sector
- Information technology sector
- Miscellaneous.

This system of classification has been found useful in resource allocation at macro level.

Techno-Economic Projects

Classification of projects based on techno-economic characteristic fall in this category. This type of classification includes factors intensity-oriented classification, causation oriented classification as discussed below.

(*a*) ***Factor Intensity-Oriented Classification*:** Based on this projects may be classified as capital intensive or labor intensive if large investment is made in plant and Preparation of machinery the project

will be termed as capital intensive. On the other hand project involving large number of human resources will be termed as "labor intensive".

(*b*) ***Causation-Oriented Classification:*** On the basis of causation, projects can be classified as demand based and raw material based projects. The availability of certain raw materials, skills or other inputs makes the project raw-material based and the very existence of demand for certain goods or services make the project demand-based.

(*c*) ***Magnitude-Oriented Classification:*** This is based on the size of investment involved in the projects, accordingly project are classified into large scale, medium-scale or small-scale projects.

The selection of a project consists of two main steps: Project identification and project selection.

2.16 PROJECT IDENTIFICATION

Often indenting entrepreneurs always are in search of project having a good market but how without knowing the product coat they determine market whose market they find out without knowing the item *i.e.,* product? Idea generation about a few projects provides a way to come out of the above tangle.

Idea Generation

The process of project selection starts with idea generation. In order to select most promising and profitable project, the entrepreneur has to generate large number of ideas about the possible projects he can take. The project ideas can be discovered from various internal and external sources. These may include:

1. Knowledge of potential customer needs.
2. Personal observation of emerging trends in demand for certain products.
3. Scope for producing substitute product.
4. Trade and professional magazines which provide a very fertile source of project ideas.
5. Departmental publications of various departments of the government.
6. Success stories of known entrepreneurs or friends or relatives.
7. A new product introduced by the competitor.
8. Ideas given by knowledgeable persons.

All these sources putting together may give few ideas about the possible projects to be examined among which the project must be selected. After

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going through these sources if an entrepreneur has been able to get six project ideas, one project idea will be finally selected going through the following selection process.

Project Selection

Project selection starts once the entrepreneur has generated few ideas of project. After having some ideas, these project ideas are analyzed in the light of existing economic conditions, market conditions, and the government policy and so on. For this purpose a tool is generated used what is called SWOT analysis. The intending entrepreneur analyses his strengths and weaknesses as well as opportunities/competitive advantages and threats/challenges offered by each of the project ideas. In addition the entrepreneur needs to analyze other related aspects also like raw material, potential market, labor, capital, location and forms of ownerships etc. Each of these aspects has to be evaluated independently and in relation to each of these aspects. This forms a continuous and back and forth process as shown in Fig. 2.8.

On the basis of this analysis, the most suitable idea is finally selected to convert it into an enterprise. The process involved in selecting a project out of few projects is also termed as "Zeroing in Process".

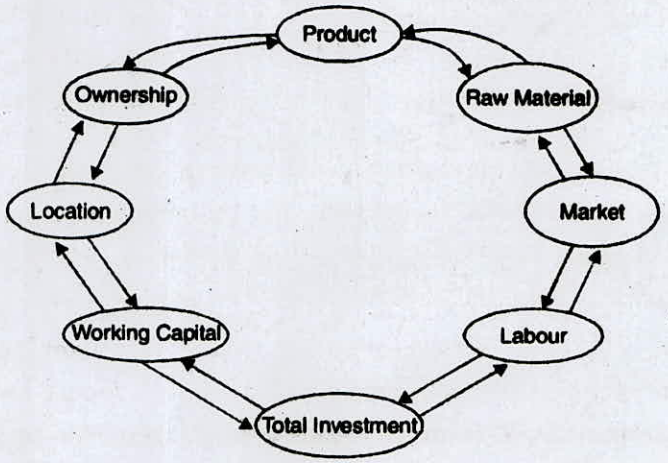

Fig. 2.8. *Interdependent aspects of projects*

Readers are advised to note that there is a time interval involved in between project identification and project selection. In some cases it may be few months and in others it may be few minutes.

2.17 MEANING AND SIGNIFICANCE OF PROJECT REPORT

As is discussed in the previous section, Webster new 20th century dictionary defines as a scheme, design a proposal something intended or devised. A

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project report or a business plan is a written statement of what an entrepreneur proposes to take up. It is a kind of guide frost or course at action what the entrepreneur hopes to achieve in his business and how is he going to achieve it. A project report serves like a kind of big road map to reach the destination determined by entrepreneur. Hence a project report can be defined as a well evolved course of action devised to achieve the specified objectives within a specified period of time. It is like an operating document.

The preparation of project report is of great significance for an entrepreneur. The project report serves two essential purposes. The first is the project report is like a road map it describes the direction the enterprise is going in, what its goals are, where it wants to be, and how it is going to get there. In addition it enables the entrepreneur to know that he is proceeding in the right direction. Dan Steinhoff and John F. Burgess hold the view that without well spelled out goals and operational methods, most businesses flounder on the rocks of hard times. The second purpose of the project report is to attract lenders and investors. The preparation of project report is beneficial for those small scale enterprises which apply for financial assistance from the financial institutions and commercial banks. On the basis of this project report the financial institutes make appraisal and decide whether financial assistance should be given or not. If yes how much. Other organizati ons which provide various assistance like work shed/land, raw material etc, also make decision on the basis of this project report.

2.18 CONTENTS OF A PROJECT REPORT

The significance of project report as discussed above makes it clear that there is no substitution for business plan or project report and there are no shortcuts to prepare it. The more concrete and complete project report not only serves as road map but also earns the respect of outsiders who support in making and running an enterprise. Hence project report should be prepared with great care and consideration. A good project report should contain the following.

1. ***General Information***: Information on product profile and product details.
2. ***Promoter***: His/her educational qualification, work experience, project related experience.
3. ***Location***: exact location of the project, lease or freehold, location advantages.

4. ***Land and Building***: land area, construction area, type of construction, cost of construction, detailed plan and estimate along with plant layout.
5. ***Plant and Machinery***: Details of machinery required, capacity, suppliers, cost, various alternatives available, cost of miscellaneous assets.
6. ***Production Process***: Description of production process, process chart, technical know how, technology alternatives available, production programme.
7. ***Utilities***: Water, power, steam, compressed air requirements, cost estimates sources of utilities.
8. ***Transport and Communication***: Mode, possibility of getting costs.
9. ***Raw Material***: List of raw material required by quality and quantity, sources of procurement, cost of raw material, tie-up arrangements, if any for procurement of raw material, alternative raw material, if any.
10. ***Man Power***: Man power requirement by skilled and semi-skilled, sources of manpower supply, cost of procurement, requirement for training and its cost.
11. ***Products***: Product mix, estimated sales distribution channels, competitions and their capacities, product standard, input-output ratio, product substitute.
12. ***Market***: End-users of product, distribution of market as local, national, international, trade practices, sales promotion devices, proposed market research.
13. ***Requirement of Working Capital***: Working capital required, sources of working capital, need for collateral security, nature and extent of credit facilities offered and available.
14. ***Requirement of Funds***: Break-up project cost in terms of costs of land, building machinery, miscellaneous assets, preliminary expenses, contingencies and margin money for working capital, arrangements for meeting the cost of setting up of the project.
15. Cost of production and profitability of first ten years.
16. Break-even analysis.
17. Schedule of implementation.

2.19 FORMULATION OF PROJECT REPORT

A project report is like a road map. It is an operating document. What information and how much information it contain depends upon the size of

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the enterprise, as well as nature of production. For example small-scale enterprises do not include technology which is used for preparing project reports of large-scale enterprises. Within small-scale enterprises too, all information may not be homogeneous for all units. Vinod Gupta has given a general set of information in his study "Formation of a project report." According to Gupta, project formulation divides the process of project development into eight distinct and sequential stages as below:

(1) General information

(2) Project description

(3) Market potential

(4) Capital costs and sources of finance

(5) Assessment of working capital requirements

(6) Other financial aspects

(7) Economical and social variables

(8) Project implementation

The nature of formation to be collected and furnished under each of these stages has been given below.

(1) General Information

The information of general nature given in the project report includes the following:

Bio-Data of Promoter: Name and address, qualifications, experience and other capabilities of the entrepreneur. Similar information of each partner if any.

Industry Profile: A reference analysis of industry to which the project belongs, *e.g.,* past performance; present status, its organization, its problems etc.

Constitution and Organization: The constitution and organization structure of the enterprise; in case of partnership firm its registration with registrar of firms, certification from the directorate of industries /district industry centre.

Product Details: Product utility, product range, product design, advantage to be offered by the product over its substitutes if any.

(2) Project Description

A brief description of the project covering the following aspects should be made in the project report.

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Site: Location of the unit; owned, rented or leasehold land; industrial area; no objection certificate from municipal authorities if the enterprise location falls in the residential area.

Physical Infrastructure: Availability of the following items of infrastructure should be mentioned in the project report.

(*a*) ***Raw Material:*** Requirement of raw material, whether inland or imported, sources of raw material supply.

(*b*) ***Skilled Labour:*** Availability of skilled labour in the area *i.e.*, arrangements for training labourers in various skills.

(*c*) ***Utilities***: These include:

- *Power:* Requirement of power, load sanctioned, availability of power
- *Fuel:* Requirement of fuel items such as coal, coke, oil or gas, state of their availability and supply position.
- *Water:* The sources of water, quality and quantity available.
- *Pollution Control:* The aspects like scope of dumps, sewage system, sewage treatment plant, infiltration facility etc., should be mentioned.
- *Communication and Transportation Facility:* The availability of communication facilities, *e.g.*, telephone, fax, telex, internet etc., should be indicated. Requirements for transport, mode of transport, potential means of transport, approximate distance to be covered, bottlenecks etc., should be stated in the business plan.
- *Production Process:* A mention should be made for process involved in production and period of conversion from raw material into finished goods.
- *Machinery and Equipment:* A complete list of machines and equipments required indicating their size, type, cost and sources of their supply should be enclosed with the project report.
- *Capacity of the Plant:* The installed licensed capacity of the plant along with the shifts should also be mentioned in the project report.
- *Technology Selected:* The selection of technology, arrangements made for acquiring it should be mentioned in the business plan.
- *Other Common Facilities:* Availability of common facilities like machine shops, welding shops and electrical repair shops etc., should be stated in the project report.
- *Research and Development:* A mention should be made in the project report regarding proposed research and development activities to be undertaken in future.

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(3) Market Potential

While preparing a project report, the following aspects relating to market potential of the product of the product should be stated in the report.

(*a*) *Demand and Supply Position:* State the total expected demand for the product and present supply position, what is the gap between demand and supply and how much gap will fill up by the proposed unit.

(*b*) *Expected Price:* Expected price of the product to be realized should also be mentioned.

(*c*) *Marketing Strategy:* Arrangements made for selling the product should be clearly stated in the project report.

(*d*) *After Sales Service:* Depending upon the nature of the product, provisions made for after-sales should normally be stated in the project report.

(4) Capital Costs and Sources of Finance

An estimate of the various components of capital items like land and buildings, plant and machinery, installation costs, preliminary expenses, margin of working capital should be given in the project report. The sources should indicate the owners funds together with funds raised from financial institutions and banks.

(5) Assessment of Working Capital

The requirement for working capital and its sources of supply should clearly be mentioned. It is preferred to prepare working capital requirements in the prescribed formats designed by limits of requirement. It will reduce the objections from banker's side.

(6) Other Financial Aspects

To adjudge the profitability of the project to be set up, a projected profit and loss account indicating likely sales revenue, cost of production, allied cost and profit should be prepared. A projected balance sheet and cash flow statement should also be prepared to indicate the financial position and requirements at various stages of the project. In addition to this, the break even analysis should also be presented. Break even point is the level of production at which the enterprise shall earn neither profit nor incur loss. Breakdown level indicates the gestation period and the likely moratorium required for repayment of the loans. Break-even point is calculated as

$$\text{Break-Even Point (BEP)} = F/S - V$$

Where F = Fixed Cost

S = Selling Price/Unit

V = Variable Cost/Unit

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The break-even point indicates at what level of output the enterprise will break even.

(7) Economical and Social Variables

Every enterprise has social responsibility. In view of the social responsibility of business, the abatement costs, *i.e.*, the costs for controlling the environmental damage should be stated in the project. Arrangements made for treating the effluents and emissions should also be mentioned in the report. In addition the following socio-economic benefits should also be stated in the report.

(*i*) Employment Generation

(*ii*) Import Substitution

(*iii*) Ancillaration

(*iv*) Exports

(*v*) Local Resource Utilization

(*vi*) Development of the Area.

(8) Project Implimentation

Every entrepreneur should draw an implementation scheme or a time-table for his project to the timely completion of all activities involved in setting up an enterprise. If there is delay in implementation project cost overrun. Delay in project implementation jeopardizes the financial viability of the project, on one hand, and props up the entrepreneur to drop the idea to set up an enterprise, on the other. Hence there is need to draw up an implementation schedule for the project and then to adhere to it. PERT and CPM discussed later in this chapter can be used to get better insight into all activities related to implementation of the project.

2.20 PLANNING COMMISSION GUIDELINES

In order to process investment proposals and arrive at investment decisions, the planning Commission has issued guidelines for preparing/formulating industrial projects. The guidelines have been summarized as follows:

1. ***General Information*:** The feasibility report should include an analysis of the industry to which the project belongs. It should deal with the past

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performance of the industry. The description of the type of industry should also be given, *i.e.,* the priority of the industry, increase in production, role of the public sector, allocation of investment of funds, choice of technique, etc. This should contain information about the enterprise submitting the feasibility report.

2. ***Preliminary Analysis of Alternatives*:** This should contain present data on the gap between demand and supply for the outputs which are to be produced, data on the capacity that would be available from projects that are in production or under implementation at the time the report is prepared, a complete list of all existing plants in the industry, giving their capacity and their level of production actually attained, a list of all projects for which letters of intent licenses have been issued and a list of proposed projects. All options that are technically feasible should be considered at this preliminary stage. The location of the project and its implications should also be looked into. An account of the foreign exchange requirement should be taken. The profitability of different options should also be looked into. An account of the foreign exchange requirement should be taken. The profitability of different options should also be given. The rate of return on investment should be calculated and presented in the report. Alternative cost calculations vis-à-vis return should be presented.
3. ***Project Description*:** The feasibility report should provide a brief description of the technology/process chosen for the project. Information relevant for determining the optimality of the location chosen should also be included. To assist in the assessment of the environmental effects of a project every feasibility report must present the information on specific points, *i.e.,* population, water, land, air, flora, fauna, effects arising out of the project's pollution, other environmental destruction, etc. The report should contain a list of important items of capital equipment and also the list of the operational requirements of the plant, requirements of water and power, requirements of personnel, organizational structure envisaged, transport costs, activity wise phasing of construction and factors affecting it.
4. ***Marketing Plan*:** It should contain the following items: Data on the marketing plan, demand and prospective supply in each of the areas to be served. The methods and the data used for making estimates of domestic supply and selection of the market areas should be presented. Estimates of the degree of price sensitivity should be presented. It should contain an analysis of past trends in prices.
5. ***Capital Requirements and Cost*:** The estimates should be reasonably complete and properly estimated. Information on all items of costs should be carefully collected and presented.

6. ***Operating Requirements and Costs*:** Operating costs are essentially those costs which are incurred after the commencement of commercial production. Information about all items of operating cost should be collected. Operating costs relate to cost of raw, materials and intermediaries, fuel, utilities, labour, repair and maintenance, selling expenses and other expenses.
7. ***Financial Analysis*:** The purpose of this analysis is to present some measures to asses the financial viability of the project. A Performa balance sheet for the project data should be presented. Depreciation should be allowed for on the basis specified by the Bureau of Public Enterprises. Foreign exchange requirements should be cleared by the Department of Economic Affairs. The feasibility report should take into account income tax rebates for priority industries, incentives for backward areas, accelerated depreciation, etc. The sensitivity analysis should also be presented. The report must analyze the sensitivity of the rate of return on the level and pattern of product prices.
8. ***Economic Analysis*:** Social profitability analysis needs some adjustments in the data relating to the costs and return to the enterprise. One important type of adjustment involves a correction in input and cost, to reflect the true value of foreign exchange, labour and capital. The enterprise should try to assess the impact of its operations on foreign, trade. Indirect costs and benefits should also be included in the report. If they cannot be quantified they should be analyzed and their importance emphasized.

2.21 NETWORK ANALYSIS

A project consists of a number of constituted activities. It is examined in detail and the details are utilized to compile the sequential narration of the constituent activities of a project. The compilation is known as the project logic. When it is represented in the form of a graphical portrayal it is called as network. Network in simple words is defined as the graphical representation of interrelated activities of the project. A network generally comprises a set of symbols connected with each other in a sequential relationship with each step making the completion of an event. The network diagram and scheduling computations enable the project formulation team to identify the longest series of activities through the project implementation phase which determines the project duration. A number of network techniques have been developed and some of them are discussed below:

Critical Path Method (CPM): The CPM is a logical mathematical model of the project based upon the optimal duration required for each activity and

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optimal use of available limited resources. It is a deterministic model.

Program Evaluation and Review Technique (PERT): The PERT is primarily a scheduling technique. It shows any job or project as a set of processes of operations called 'activities' which must take place in a certain sequence. All activities have to be compelled in order to accomplish the project. It is a probabilistic model and introduces uncertainties in project network.

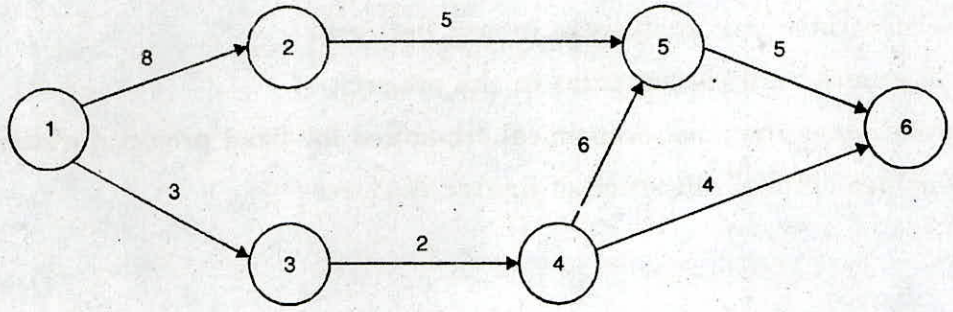
Graphical Evaluation and Review Technique (GERT): The GERT is a more recently used network. This is superior to CPM and PERT. It allows for probabilistic events while all events in CPM and PERT are deterministic. In the networks representing research and development project the process is repeated till the desired out come is achieved. CPM and PERT cannot be used in such situations. In GERT network only simulation can be used.

Line of Balance **(LOB):** Line of balance uses graphic techniques to show the progress achieved on the project with respect to key events.

Workshop Analysis Scheduling Programme (WASP): This technique of networking system was developed by the British Automatic Energy Authority. However, the most commonly used techniques are PERT and CPM.

Use of PERT**:** The following steps are used in PERT:

- The activities of the project are identified along with their interrelationships and graphically represented using networks.
- The time required for completing each activity is estimated and noted on the network.
- The minimum time required for completing the entire project is estimated.
- The critical activities are identified for the efficient allocation of resources in order to complete the project earlier, if necessary.
- Closer watch on critical and other activities so as to complete the project on time.



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The following table gives the activities and the time required to complete each activity of the project.

Activity	*Time Required to Complete Activity (Days)*
1–2	08
1–3	03
3–4	02
2–5	05
4–5	06
4–6	04
5–6	05

Path 1-2-5-6 = 8 + 5 + 5 = 18 days

Path 1-3-4-6 = 3 + 2 + 4 = 09 days

Path 1-3-4-5-6 = 3 + 2 + 6 + 5 = 16 days

Since the path 1-2-5-6 consumes longest time, it is known as critical path and the activities 1-2, 2-5 and 5-6 are known as critical activities. Hence the project completion time is 18 days.

Use of CPM: The CPM is almost similar to the PERT. However it is activity oriented and focuses on cost and not time. The CPM is generally used to find the optimum project cost and time. The optimum project cost is the minimum cost at which the project can be completed. This can be determined by using the concept of crashing of activities. Crashing of activity is nothing but reducing the time required to complete an activity, by allocations additional resources, which adds cost. CPM is also used to find minimum time at which a project can be completed, irrespective of cost, which may be necessary under crisis situations.

Advantages of PERT

1. It determines the expected duration of activities and consequently of the project duration.
2. It incorporates risk analysis in project network.
3. It determines critical activities in the project.
4. It determines the most economical scheduled for fixed project duration.
5. It enables optimal allocation of limited resources.

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Limitations of PERT

1. The time estimates to perform activities constitutes a major limitation of this technique.
2. The probability distribution of total time is assumed to be normal which in real life situations may not be true.
3. The simple PERT technique does not consider the resources required at various stages. If a certain resource must be used to perform more than one activity and at the same time if it can be used for only one activity at a time then the network diagram will become infeasible.

Advantages of CPM

1. CPM allows for a comprehensive view of the entire project. Because of the sequential and concurrent relationships, time scheduling becomes very effective.
2. Identifying critical activities keeps the project manager alert and in a state of preparedness, with alternative plans ready in case these are needed.
3. Selective management principle may be used in project management. In the network analysis, the critical activities become item 'A' the sub-critical activities item 'B' and all others, item 'C'. Breaking down the project into smaller components permits better and closer control.
4. Through the plan schedule derived from CPM, delegation can be effectively practised.

Limitations of CPM

1. CPM is deterministic model based on certainty assumptions as regards time. But it may not be true in practice.
2. CPM does not use statistical analysis in making time estimates.
3. It cannot be used as a controlling device since any changes introduced will alter the entire structure of network.

Differences between PERT and CPM

Though both PERT and CPM are used for managing projects, yet there are differences between them. These are listed in table.

PERT	CPM
1. It is event oriented approach	It is an activity oriented approach
2. It allows uncertainty	It does not allow uncertainty
3. It is probabilistic model	It is deterministic model
4. It is time based	It is cost based
5. It averages time	It does not average time
6. It has three estimates of time	It has single estimate of time
7. It is suitable when high precision is required.	It is suitable where reasonable precision is required.

2.22 COMMON MISTAKES BY ENTREPRENEURS IN PROJECT FORMULATION

Entrepreneurs do make mistakes while selecting and formulating their projects and evolving business plans. Some of the common errors found in project formulation are:

1. ***Selection of Project Area:*** Entrepreneurs select wrong area of product or service by studying wrong or exaggerated data of particular industries. This happens particularly when entrepreneur gets data from the presentations and projections made by experts in the field or exhibitions or from trend analysis. The selection of a product without detailed study of product market, demand patterns, competition in the industry, change of customer taste and perceptions or mistaken overview of the demand pattern. Usually an entrepreneur selects a product which he knows best or where he has worked for long years. Example: A marketing man in textile is likely to choose textile as his product.
2. ***Market Study and Analysis:*** Market research, study and analysis is a critical aspect for an entrepreneur in selection of a product and market segment. Any decision based on scanty, wrong or un-organized data will give a distorted demand picture leading to wrong choices. An entrepreneur should also choose products' based on the objective studies and not go by his previous experience, avoiding likes and dislikes in his personal capacity.
3. ***Selection of Technology:*** An appropriate technology is necessary for any new enterprise for its survival and growth. A wrong selection of technology leads to problems of costs, profit margins and feasibility issues of the entire project.
4. ***Optimistic Estimates:*** Over optimistic estimates by the entrepreneurs in the area of productivity, capacity utilization, prevailing marketing conditions, under estimation of competitors and pricing give wrong selection of products. Any business plan made by an entrepreneur based on wrong

data, financial jugglery will give problems in selection and implementation of the project.

5. ***Ownership Form:*** A suitable ownership form be evolved for the project to avoid stoppages and disputes.
6. ***Selection of Location:*** An entrepreneur should not be tempted select locations that are not viable. A location is almost permanent to any project and as such plays an important role in cost competitiveness and viability of the organization throughout its life. An entrepreneur is tempted usually on three counts, first the cheapness on and second love of the native place of the entrepreneur and third the incentives offered by the government agencies for location of industries. It could be seen that all the three alternative give a broad idea of the costs whereas the selection be made only on the basis of techno-economic analysis and overall benefits to the proposed projects. In order to process investment proposals and arrive at investment decisions, of the Planning Commission has issued guidelines for preparing formulating industrial projects. The guidelines have been summarized as follows.

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2.23 PROJECT APPRAISAL: MEANING AND DEFINITION

Project appraisal is an exercise where by, a lending financial institution makes an independent and objective assessment of various aspects of an investment proposition to arrive at the financial decision. Project appraisal means the assessment of project in terms of its economic, social and financial viability. It is a complete scanning of the project. Usually banks and financial institutions conduct a critical appraisal of projects, which are submitted to them by the entrepreneur for getting loans. They have been traditionally accepting the data provided by the entrepreneur as valid while assessing the project. In fact the emphasis has largely been on the cash flow and financial viability of a project in assessing their suitability for extending the loans. Project appraisal can be defined as the promoter taking a second look critically and carefully at a project as presented by the promoter person who is no way involved in or connected with its preparation and who is as such able to take an independent dispassionate and objective view of the project in its totality as also in respect of its various components. The person who carries out appraisal of project is usually a team of institutional officials.

The appraisal of proposed project includes the following analysis:

1. ***Economic Analysis:*** An economic analysis looks at the project from the viewpoint of the whole economy, asking whether the latter will show benefits sufficiently greater than project cost to justify investment in it.

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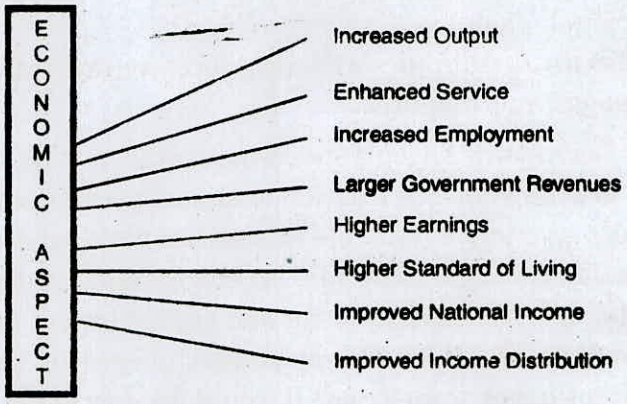
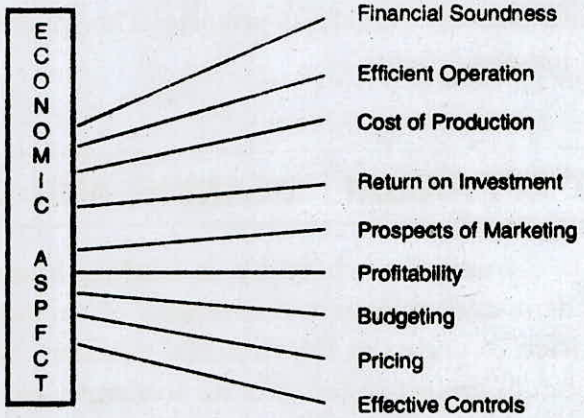


2. ***Financial Analysis*:** The purpose of the appraisal of the financial aspects of a project is generally to ensure its initiation of financial conditions for the sound implementation and efficient operation.



3. ***Market Analysis*:** Financial institutions examine the project to ensure economic justification of investment details. They study the marketing scope of the project and also its worth to the national economy by analyzing the consumption pattern and the potential demand for the project.

Market Analysis Covers the Following

- Anticipated market for the product
- Analysis of market opportunity and specifying marketing objectives
- Planning the process of marketing the product
- Organization for the marketing process
- Life cycle of the product

4. ***Technical Analysis*:** Technical appraisal of a project broadly involves a critical study of the following:
   - *Location and Site:* There are a number of aspects that influence industrial location because it may significantly influence the cost of

production and distribution efficiency, the operating environment etc. The important factors that influence industrial location are raw material, proximity to market, availability of water, power, transportation facilities, man power, labor laws, taxes, incentives, subsidies etc. The factors to be considered for selection of site are load bearing capacity, access to water, effluent discharge etc.

- *Size of the Plant/Scale of Operation:* The size of the plant determines the economic and financial liability of a project. An important aspect of size is the available process technology. Equipment is often standardized at specific capacities in production sectors. Operative capacities in such sectors are therefore available only in certain multiples.
- *Technical Feasibility:* The appraisal of the technical aspects involves scrutiny of such aspects of the project as
  - o Technology selected
  - o Technical collaboration arrangements made
  - o Capacity/Size of the project
  - o Selection of plant, machinery and equipment
  - o Plant layout and factory building
  - o Technical and engineering services.

5. ***Organizational Analysis*:** As a lender and development institution, the banks and other financial institutions place particular stress on the need and efficient organization and responsible management for the execution of the project. During project appraisal, these two aspects of a project are examined. If both aspects are not carried out properly, short term remedial steps are recommended to the entrepreneur. The objective of this aspect of appraisal is to make sure that the project is adequately carried out. The various organizational aspects are organization, structure, recruitment, training and development and so on.
6. ***Managerial Aspects*:** If the management is incompetent, even a good project may fail. It is rightly pointed out that if the project is week, it can be improved upon but if the promoters are week and lack in business acumen, it is difficult to reverse the situation. To safeguard from this problem, the financial institutions can exercise control over the assisted units. There is a provision for appointment by the financial institutions of nominee directors on the boards of all MRTP companies assisted by them. The companies act, the industries act (Development and Regulation), empower government to exercise powers of control over the management, including the take over of management of industrial undertakings. All

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these indicate the importance given to proper managerial strategies to prevent mismanagement. If the proper appraisal of the managerial aspects is made in the beginning itself, future problems in this area can be avoided to a very large extent.

2.24 IDENTIFICATION OF OPPORTUNITY

The reason for anyone to think of establishing an SSI unit can be summarized in single word—opportunity. The opportunity to be your own boss, to implement your own ideas, to earn for himself or herself is reason to think of starting an SSI unit. Starting an SSI needs a lot of courage. To be successful, to stay in the business an entrepreneur needs combination of hard work, skill and perseverance.

Entrepreneur who starts their own business can be grouped into two broad categories. The first category consists of people who know exactly what they want to do and are merely looking for the opportunity or resources to do it. These people may already developed many of skills necessary to succeed in their chosen field and are also likely to be familiar with industry customs and practices, which can help during the start-up phase of a new business.

The second group consists of people who want to start their own business, but do not have definite ideas about what may would like to do. They may have developed skills during their education or in the course of their previous employment, but many have not be interested in opening a business in the same field of endeavor. Project identification is concerned with the collection complication and analysis of data for the eventual purpose of locating possible opportunities for investment and with the development of the characteristics of such opportunities. Opportunities, according to Drucker, are of three kinds: additive, complimentary and break-through. Adiptive opportunities are those opportunities which enable the decision maker to better utilize the existing resources without in any way involving a change in the character of business. Complementary opportunities involve the introduction of new ideas and as such do lead to certain amount of change in the existing structure. Breakthrough opportunities on the other hand, involve fundamental changes in both the structure and character of business. Additive opportunities involve the least amount of disturbance to the existing state of affairs and hence the least amount of risk. The element of risk is more in other two opportunities. Project identification cannot be complete without identifying the characteristics of the project. Every project has three elements—inputs, outputs and social costs and benefits. The input characteristics define what the project will consume in terms of raw material, energy, manpower, finance

and organizational setup. The native and magnitude of these input must be determined in order to make the input characteristics explicit. The output characteristics of a project define what the project will generate in the form of goods and services, employment revenue etc. The quantity and quality of all these output should be clearly specified. In addition every project will have impact on society. It inevitably affects the current equilibriums of demand and supply in the economy. It is necessary to evaluate carefully the sacrifice which the society will be required to make and the benefits will not accrue to the society from a given project.

2.25 PROJECT FEASIBILITY STUDY

Project feasibility analysis is carried out to ensure viability of project. The important project feasibility study is

1. Market feasibility
2. Technical feasibility
3. Financial feasibility
4. Economic feasibility
5. Ecological feasibility.

Market Feasibility

Market feasibility is concerned with two aspects the aggregate demand for the proposed product/service, the market share of the project under consideration. For this market analysis requires variety of information and appropriate forecasting methods. The kind of information required is

- Consumption trends in the past and the present consumption level
- Past and present supply position
- Production possibilities and constraints
- Imports and exports
- Structure of competition
- Cost structure
- Elasticity of demand
- Consumer behavior, intentions, motivations, attitudes, preferences and requirements
- Distribution channels
- Administrative, technical and legal constraints.

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Technical Analysis

Technical analysis seeks to determine whether prerequisites for successful commissioning of the project have been considered and reasonably good choices have been made with respect to location, size, and so on. The important questions raised in technical analysis are:

- Has the availability if raw material, power, and other inputs been established?
- Is the selected scale of operation optimal?
- Is the production process chosen suitable?
- Are the equipment and machines chosen appropriate?
- Have the auxiliary equipment and supplementary engineering works been provided for?
- Has provision been made for treatment of effluents?
- Is the proposed layout of the site, buildings and plant sound?
- Have work schedules been drawn up realistically?
- Is the technology proposed to be employed appropriate from the social point of view?

Financial Analysis

Financial analysis is necessary as ascertain whether the propose project is financially viable in the sense of being able to meet the burden of servicing dept and whether the propose project will satisfy the return expectations of those who provide the capital. The aspects to be looked into while conducting financial appraisal are as follows.

- Investment outlay and cost of project
- Means of financing.
- Project profitability
- Break-even point
- Cash shows of the project
- Investment worthiness judged in terms of various criteria of merit
- Project financial position
- Level of risk.

Economic/Social Cost-Benefit Analysis

This is concerned with judging a project from the larger social point of view, where in the focus if on social costs and benefits of a project, which may

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often be different from its monitory costs and benefits. The questions to be answered in social cost-benefit analysis are as follows.

- What are the direct economic benefits and costs of the project measured in terms of shadow (efficiency) prices and not in terms of market prices?
- What would be the impact of the project on the distribution of income in the society?
- What would be the impact of the project on the level of savings and investment in the society?
- What would be the contribution of the project towards the fulfillment of certain like self-sufficiency, employment and social order?

Ecological Analysis

Today, environmental concerns assured a great deal of significance and hence ecological analysis should be done, particulars for project which have significant ecological implications like power plants and irrigation schemes and for environmental polluting industries like chemicals, leather processing etc. The key questions to be answered in ecological analysis are as follows.

- What is the likely damage caused by the project to the environment?
- What is the cost of restoration measures required to ensure that thedamage to the environment is contained within acceptable?

2.26 SUMMARY

- Creativity also has many different definitions depending on the context.
- Step change innovation occurs not just because of technology changes but as a result of groundbreaking, creative ideas throughout the organization.
- Incremental innovation covers all the small-scale improvements that occur on a daily basis throughout the organization.
- As a result of these discontinuities industries are characterized by creative destruction, or waves of new firm creation and failures, often referred to as 'shake outs'.
- In general new products that offer extra value for customers can carry a premium price.
- Brainstorming is a commonly used technique for idea generation but the results will not be as good as they might be if it is not carried out systematically.

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- Quantifiable projects are those in which possible quantitative assessment of benefits can be made. Non-quantifiable projects are those where such assessment is not possible.
- The significance of project report as discussed above makes it clear that there is no substitution for business plan or project report and there are no shortcuts to prepare it.
- In order to process investment proposals and arrive at investment decisions, the planning Commission has issued guidelines for preparing/formulating industrial projects.
- The CPM is a logical mathematical model of the project based upon the optimal duration required for each activity and optimal use of available limited resources. It is a deterministic model.
- Project appraisal is an exercise where by, a lending financial institution makes an independent and objective assessment of various aspects of an investment proposition to arrive at the financial decision.

2.27 REVIEW QUESTIONS

1. Explain the concepts of technical discontinuities and industry breakpoints. Using examples from one sector explain how the opportunities that result from them can be exploited by an entrepreneurial organization.
2. Choose an organization that you consider to be very innovative. How has it achieved success so far and how can this be maintained in the future?
3. With a track record of successful entrepreneurship you have taken over responsibility for an organization that has a poor record of innovation. Explain the issues you would expect to have to resolve and the key actions that you would take to achieve a more innovative culture within the company.
4. As a speaker at a conference of managers of small- and mediumsized organizations from both public and private sectors, you have been asked to give a talk entitled 'Innovation in the small organization'. Prepare the slides for your talk and include notes that refer to the important concepts you wish the delegates to remember and examples to illustrate the points you make.
5. As a newly appointed town centre manager in a run-down region of the country explain the steps you would take to begin the process of regeneration.
6. As a specialist consultant to the industry write a report identifying some potential sources of business opportunity for a major investor in the home entertainment industry.
7. If you were establishing a new product and service development process in an organization what methods would you suggest to encourage staff to identify new ideas?

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8. What advantages do small firms have over large ones in exploiting market opportunities?
9. The process of exploiting an opportunity from the initial idea to commercialization can be expensive and time-consuming. How can a new or smaller organization reduce the time and costs involved?
10. How might environments that encourage networking (*e.g.*, business incubators) support small firms in exploiting opportunities?
11. Explain in brief the meaning of project.
12. Discuss the classification of projects.
13. Write a note on the following

    (*a*) Idea generation (*b*) Project selection
14. What do you mean by a project report? Explain in brief the contents of project report.
15. Discuss the guidelines of planning commission for project report.
16. List the merits and demerits of PERT and CPM.
17. Explain the steps involved in using PERT and CPM.
18. Write a note on errors in project report.
19. What do you mean by project appraisal? Explain various types of analysis used in project appraisal.
20. Write a note on

    (*a*) Identification of opportunity (*b*) Feasibility study

2.28 FURTHER READINGS

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UNIT 3 INTERNATIONAL ENTREPRENEURSHIP OPPORTUNITIES

★ STRUCTURE ★

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3.0 LEARNING OBJECTIVES

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

- define what is the nature of international entrepreneurship?
- explain the incentives and facilities.
- describe the institutional support for new ventures.
- differentiate between financial institutions and small scale industries.
- discuss about the supporting organizations.

3.1 INTRODUCTION

Globalization thus far has been primarily the activity of international giants. Global giants such as Sony, Toyota, GM, and IBM have been thriving on globalization as they expand their market appeal and their outreach to the richest and most advanced markets of the world. As has been discussed in

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my earlier books and by many other scholars of globalization, by definition, these giants go to the best markets of the world. As they concentrate on these markets they ignore the rest of the world's undeveloped markets. As these giants function they accumulate much economic wealth. However, this economic wealth is concentrated in the hands of a few privileged markets as the rest of society experiences a growing gap of economic well-being between the rich and poor(Samli 2004, 2008, Isaak 2005).

In addition to these global giants' ignoring small regional markets of the third world, they also become too big and rather dysfunctional. According to some authors, all major companies have been entrepreneurially oriented at the beginning, but in time they become very large, and their administrative practices suffocate their entrepreneurial orientation (Sciascia et al. 2007). Thus, not only do they function in certain geographic areas exclusively and are more interested in accumulating economic power for themselves, but they truly cease to generate new ideas, new jobs, or new products that would be useful to the poorer parts of global markets. Instead, they are engaged in top-down globalization, which is more of an extension of economic power grabbing. If new businesses are created as extensions of the global giants, they unfortunately bypass the forgotten majority (Samli 2004, 2008).

Although there also are companies coming out of third-world countries through globalization, they appear to be following the same pattern as the topdown globalization of global giants once again (Sledge 2007). For example, two Korean companies that have started small and produced for Japan now have become big global gigantic entities. These are Samsung and Emerson. This is more of an accustomed pattern that is easier to imitate rather than taking a major risk and going in the direction of bottom-up globalization. Globalization, in a broad sense, is the closer integration of the countries and people of the world, which is made possible by a significant reduction of transportation and communication costs and the reduction of barriers to the flow of goods and services (Stiglitz 2002). Since its appearance in the early 1970s, there have been many scholarly and not so scholarly discourses of the term globalization (Fiss and Hirsch 2005). Although much has been expected from it, globalization has not delivered enough in that its benefits did not reach out to the poorer parts of the world (Hertz 2001, Samli 2004, Stiglitz 2002). Finally and most shockingly, some large firms are doing substantial business in the market for the working poor. Not only do they have an audacious drive to extract more profits by selling high-priced products to the working poor, but they are succeeding, and their number is growing (Grow et al. 2007). Nike and Polo, for instance, have charged much higher prices

in some of the poor markets of the world.With very powerful advertising and marketing strategies they have managed to establish an extremely popular image for themselves.

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3.2 GLOBALIZATION–PAST

Globalization is not a new concept. There always have been global giants in existence and indeed there were also not so gigantic importers and exporters. However, past globalization was not a large-scale activity in today's terms. Older generations did not generate a flow of valuable consumer information that should have spread throughout the globe and sparked a far-reaching positive economic movement. Thus, globalization did not play nearly as major a role as it was expected to in the world's economic well-being.

3.3 GLOBALIZATION–PRESENT

One may consider the beginning of current globalization activity as post-World War II. As Japan developed its economy, as Europe normalized its industrial activity, as the USSR became an industrial power, trade and competition started flourishing. Four flows accelerated the process: capital flow, information flow, technology flow, and know-how flow (Samli 2004). Not only did the nature of trade change, but with the tremendous flow of information and with the arrival of the internet, consumers, rich and poor, became more aware of the availability of a large variety of products and services. They became more demanding and more sophisticated with regard to the quality and functions of products and services. During the 1960s, 1970s, and 1980s, newly industrialized countries emerged, thanks to technology transfer and its specifically generated lucrative new markets for international products. This is the era in which the Asian Four Tigers (*i.e.*, Singapore, Hong Kong, Taiwan, and South Korea) emerged as successful developments that moved from third world to first world. But again, this powerful force called globalization did not reach out to the very poor parts of the world.

3.4 GLOBALIZATION–FUTURE

As has already been touched upon, as globalization gained power and momentum, economic well-being concentrated only in certain areas.

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Globalization is not solely responsible for this outcome; however, at the writing of this book about four billion people around the world, which is approximately two thirds of the total world population, are living on three dollars a day or less. About one and a half billion of this group are managing on a one-dollar-a-day type of budget (Samli 2004).

Although globalization can perform miracles in improving the economic picture of the whole world, it is not even close to achieving such a goal. In fact, if the current conditions do not change, globalization will continue generating a greater gap between haves and have-nots. This is primarily because the current globalization process is top-down. As such, powerful governments and global giant companies are concentrating on certain industries and certain regions selectively. Thus, with the experience and knowledge gained from the current globalization process, it is quite possible, in fact necessary, to generate a second wave of globalization which is bottom-up. This activity is based on small entrepreneurial performances. Since global giants are barely interested in dealing with the small, poor, and scattered markets of the third world, clearly something has to be done with the economic inequality that is growing nonstop (Samli 2008). On the positive side, small entrepreneurial firms generate more innovative economic activity and create more new jobs than their gigantic counterparts. Unfortunately, governments, along with global giants, as mentioned earlier, are playing favoritism and helping the current pattern of globalization to continue and even expand further. Future globalization needs to be radically different from the current process. I call this the second wave of globalization, which is from the bottom-up (Samli 2008). This second wave must intentionally support entrepreneurial activity in the form of bottom-up globalization so that the power of ever expanding top-down globalization will be balanced.

3.5 NATURE OF INTERNATIONAL ENTREPRENEURSHIP

As the current top-down economic process of globalization continues, the relative well-being of the third world countries deteriorates. As mentioned earlier, globalization is not single handedly responsible for this outcome, but it is not helping the situation even though it could. As discussed earlier, globalization in its current form has supported the greed factor. This combination unchecked has been creating an intolerable gap between the haves and have-nots of the world.

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Table 3.1: Per capita income of the wealthiest and poorest nations

			Income	*% Change*
	Wealthiest	*200*	*2005*	
1	Luxemburg	44,340	65,630	48.02
2	Switzerland	38,120	54,930	44.10
3	United States	34,260	43,740	27.67
4	Japan	34.210	38,980	13.94
5	Norway	33,650	59,590	77.09
			Total	210.82
	Poorest			
1	Republic of Congo	100	120	16.67
2	Ethopia	100	160	37.50
3	Burundi	110	100	–10.00
4	Sierra Leone	130	220	40.91
5	Tajikistan	170	330	48.48
			Total	133.56

Source: *The World Bank, GNI is in U.S. Dollars using the Atlas Mthod.*

Table 3.1 presents an analysis of the world's five richest and five poorest countries. As the five richest countries' economies grew about 211%, the poorest countries grew only 134%, indicating the doubling of the gap between the two groups. This undesirable pattern has been continuing for decades now.

There does not seem to be any serious relief in sight. I have articulated elsewhere (Samli 2008) that unless top-down globalization is balanced with bottom-up globalization the world's economic picture will get uglier. As the gap between haves and have-nots becomes exorbitant it will be wishful thinking to hope that we will have a peaceful world. It is maintained throughout this book that top-down globalization must be somehow balanced by bottom-up globalization if there is a future for world peace and prosperity. This bottom-up globalization as discussed throughout this book is based on global entrepreneurship.

3.6 IMPORTANCE OF INTERNATIONAL BUSINESS TO THE FIRM

In order to appreciate the magic of entrepreneurship, it is necessary to examine why the global giants cannot reach out and cater to the poorer

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markets. They are basically handicapped in dealing with third-world markets. Table 3.2 illustrates where the global giants have difficulty in catering to scattered, small, and idiosyncratic third-world markets. The exhibit illustrates eight key areas.

- ***Inflexibility:*** Most global giants are so big and contain so many layers of decision makers who may not quite agree with each other. However, the corporate culture is such that they may not be quite versatile in terms of new ventures, new markets, and challenging new experiences.
- ***Volume Dependence:*** Global giants will not bother going to marginal or submarginal markets since they have to have large sales revenues. These markets do not offer such large revenues.
- ***Inconnectivity with Markets:*** Not only are global giants not much interested in third-world markets, but they are far removed from them. Hence, they cannot be effective even if they have had some connection with these markets. In these markets, they are likely to cause more harm than good. Above all, they cannot quite detect the sudden changes in thesemarkets and respond to them satisfactorily.
- ***High-Cost Operations:*** Unfortunately, global giants typically are overburdened with extra costs of complex and borderline dysfunction. This is caused by their multiple layers of decision making and complex decision protocols. They usually cannot quickly respond to market conditions. As an example, as this book is being written, gasoline prices are at record highs, but the automotive industry is not able to produce small, fuel efficient cars. It will take some time before they can do so.
- ***Lack of Speed:*** Organizational complexities and corporate cultures of global giants do not easily allow for effective decisions to be made quickly. They usually display delayed reactions.
- ***Being Preoccupied with Large Markets:*** Almost by definition, global giants became very gigantic by emphasizing large global markets. Of course, they do not include small and scattered markets of the poor countries since the global giants do very well in the large markets of the industrialized world.
- ***Inadequate Motivation:*** Very closely related to the previous comment, global giants lacked and still lack interest in markets of poor countries. They do not feel that there are great opportunities in these markets.

Table 3.2: Problems of global giants

Feature	*Practical Outcomes*
Inflexibility	Inability to move into new markets and adopt new ideas
Volume dependence	Unless the markets indicate presence of certain adequate volumes, they avoid them
Inconnectivity with Markets	Lack of understanding of the markets, special needs and idiosyncrasies
High-cost operations	All of the managerial and planning activities are very costly and involved
Lack of speed	Cannot make quick and adequate decisions regarding many new and small markets
Being preoccupied with large markets	Large companies have much at stake in major world markets
Inadequate motivation	Large variety of markets and needs do not create motivation for global giants to enter the poor markets
No great economic expectations	There are no immediate incentives to enter these poor markets

- No great economic expectations: Since there are hardly any radical economicdevelopment episodes in the third-world countries, international giants do not expect to enter these poor markets simply because they do not expect outstanding economic gains in thesemarkets. These points are reiterated throughout this book.

As can be seen, while they may be very adequate for major world markets, global giants fall very short of functioning and being effective in third-world markets. This situation creates a major void. As stated earlier, about four billion of the total global population, which is about two thirds of the total, continue living a very meager life on three dollars a day, and most of their needs remain unanswered (Samli 2008).

3.7 INTERNATIONAL VERSES DOMESTICS ENTREPRENEURSHIP

If global giants cannot reach out and touch the poorer marginal or submarginal markets, this void needs to be eliminated by creative, small, and flexible enterprises, which are usually created and managed by entrepreneurs. As the economic gap between the haves and have-nots grows and the number of world's poor increases, the need for such creative, small, and flexible

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entrepreneurships that are not belabored by the problems of global giants that were discussed earlier, becomes extremely critical. I described a broader picture (Samli 2004) as the second wave of globalization. This picture and related movements depend on the presence and functions of local, regional, or national entrepreneurships. Although conditions, needs, and idiosyncrasies of small local markets vary from region to region and country to country, in general terms entrepreneurs have certain features that make them ideally suited for these markets. Some of these key features are presented in Table 3.3.

Table 3.3: Normal features of entrepreneurships

Feature	*Practical Outcomes*
Flexibility	Ability to move into poorer markets and be successful
Need for small volumes	Entrepreneurs can make reasonable profits with small sales volumes
Understanding small markets	They are able to appreciate the needs of small markets and satisfy their needs.
Low-cost of operations	Small entrepreneurships are low cost and efficient operations. They can afford being in small markets.
Speedy decision making	These enterprises can make decisions fast and act upon them speedily. They can detect the changes in their markets and move accordingly
Innovatinveness	Entrepreneurships are considered to be the major source of innovative activity in most societies.
Job creation	Almost all related studies have shown that small entrepreneurs grow fast, and they generate new employment in the economy

Characteristics of Entrepreneurial Ventures

Throughout this book we define entrepreneurship as "constructive creationism." This is a take-off fromthe Schumpeterian definition of "creative destructionism." When we deal with entrepreneurship, we are discussing opportunities or situations that entail the discovery of means–ends relationships through which new goods, services, procedures or organizations are introduced to generate economic value for the company and society (Companeys and McMullen 2007). Entrepreneurship, by definition, does not happen without some proactive stimulation.

Whether this stimulation is generated by local or national governments or is activated by a Non-Governmental Organization (NGO) does not matter as long as entrepreneurial opportunities are identified and an effort is made to guide entrepreneurs in that direction. Thus, the first activity in this entrepreneurial venture is detecting entrepreneurial opportunities. Perhaps,

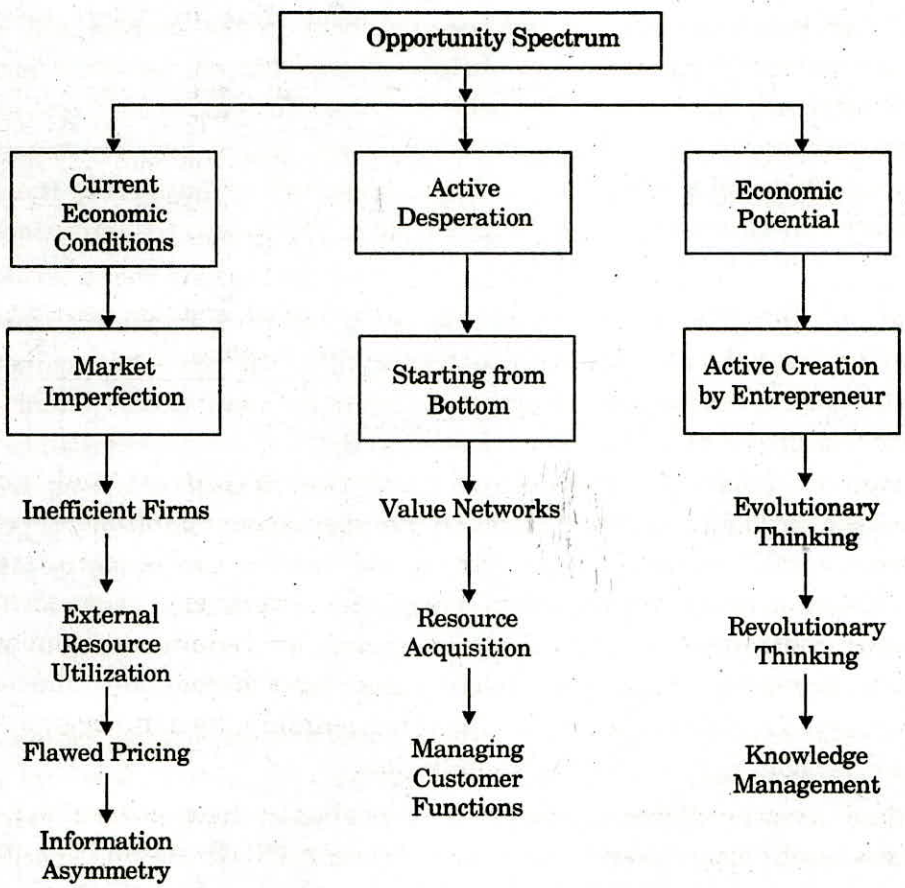
behind any entrepreneurial attempt there is the value proposition, which dwells on the benefit to be created for the custumer who is driven by the use of the proposed product or service. In other words, if the products or services generated by the entrepreneurial activity do not generate customer value that entrepreneurial activity is destined to be doomed. Customers rather than consumers are used here for a major reason.

Entrepreneurial activity is not likely to generate consumer value for everyone, but typically customer value for those who buy the product or the service generated by the entrepreneurs. In some cases, the benefit for the dealer or retailer may be so significant that it may even exceed the benefit for the user (Allen 2008). In such cases, the dealer or retailer may be very motivated to reach out further into markets.

Detecting Entrepreneurial Opportunities

The benefit to be generated by the proposed entrepreneurship can vary along the line of an opportunity spectrum. Table 3.4 presents a general picture of how entrepreneurial opportunities emerge.

Table 3.4: Entrepreneurial opportunities



At the two extremes of the opportunity spectrum two opposing situations are identified. These two extreme situations indicate the major entrepreneurial

opportunities in a country or in a region. These are current economic conditions and economic potential. While the former is an improvement of current conditions, the latter is a totally new development.

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3.8 STAGES OF ECONOMICS DEVELOPMENT

As early as 1982, Casson discussed entrepreneurial opportunities as economic conditions that entail discovery of new products, services, or production procedures all creating economic value. But as seen in table 3.5, these opportunities can be just improving current economic conditions or developing new ventures to cultivate new economic opportunities within the possibilities of the economic potential that prevails within the country or the region. Improving economic conditions stems from prevailing market imperfections that may exist. Under certain circumstances, improving the existing water supply in the country, for instance, can be significantly more beneficial than developing a new industry in the country.

As seen in table, inefficient firms can be improved whereby much economic benefit can be generated. For instance, if shoes in the country are hand-made and relatively expensive, introduction of small but efficient shoe factories can be extremely beneficial. The presence of inefficient firms may lead to misuse or improper use of the country's or region's scarce, but very important, resources. Developing ways to use these resources or improving their use noticeably can be an important contribution to the country's economic well-being.

As seen in table, flawed pricing can be easily found in imperfect markets. Flawed pricing is the almost-natural outcome of less than perfectly competitive markets. Lack of competition or concentration of economic power would make the prices of products and services skewed in favor of certain companies. The American economy is experiencing exorbitant gasoline prices as the oligopolistic petroleum industry members are receiving record levels of profits. Or, again as this book is being written, the health care industry, among many others, is charging exorbitant prices and getting away with it. These situations indicate flawed pricing that would be very harmful to many consumer groups in the markets (Cohen and Winn 2007).

Finally, information asymmetry is seen as a major market imperfection. This mostly relates to less-than-perfectly distributed information. It occurs when individuals possess different information with respect to consumers, markets, resources, and opportunities (Cohen and Winn 2007). It may be speculated that the more information asymmetry exists, the greater the opportunities for prospective entrepreneurs who would rectify some of the market imperfections stemming from the prevailing information asymmetry. On the

other end of the spectrum, entrepreneurship opportunities can be related to economic potentials of the country or the region and concentrate on developing new industries, new products, new services, and the like. Here entrepreneurs go out of the existing economic conditions and concentrate on new developments or new dimensions in the economy that will generate economic value.

In expanding the economic potential of the country and/or the region, entrepreneurs may apply evolutionary thinking to make incremental improvements in the existing systems such as introducing a fast food concept into the more middle class and busy section of a city, which may create time-saving and more nutritious eating for many people. Similarly, if entrepreneurs take a revolutionary approach so that they are not dealing with incremental but radical innovation, they may develop a portable and fast copier that may make a significant difference in offices. Whether entrepreneurs have incremental or radical orientations to stimulating the economy and capitalizing on the economic potential is critically connected to knowledge management that is prevalent in the region or the country. The two extremes of an opportunity spectrum and considerations for each are further presented in Table 3.5. On one extreme, where present conditions are improved incrementally, there may be questions such as, "just what are some of the problems of the society or the market that need attention? Who is going to be helped by incremental improvement? To what extent may the current problem be eliminated, and how effectively?" On the other end of the spectrum, the company may totally reposition itself. This may generate a new way of thinking and a new value chain. Here once again, who is going to benefit and how much become critical questions. The development may call for a totally new distribution system. Some authors maintain that the future is not strictly a continuation of the present, and that radical changes may be more effective than simple incrementalism (Samli 2007).

Table 3.5: The two extremes of opportunity spectrum

Economic Conditions Entrepreneurship	*Economic Potential Entrepreneurship*
What are some of the key problems in the world?	Reposition the compnay on the value chain by catering to an unserved market.
Who is likely to be helped by this entrepreneurship?	Create a new value chain by a new product or service.
Is it likely to eliminate a key problem?	Redefine the consumer value to be created.
What is the extent of the proposed setg of benefits?	Develop a new distribution system if necessary.

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3.9 THE THEORETICAL APPROACH

The entrepreneur has been a fundamental agent in most production, distribution and growth theories. The role of entrepreneurship as the driving force of economic growth found its most explicit foundation in Joseph Schumpeter's theory of long waves. According to Schumpeter, "Everyone is an entrepreneur when he actually carries out new combinations". Finding new combinations of factors of production is a process of entrepreneurial discovery that will become the engine that drives economic development. These "new combinations" constitute better ways to meet existing demand or create new products, often making current technologies and products obsolete (in a "process of creative destruction"). The firm of the innovative entrepreneur will, consequently, grow through the dual process of taking market share from existing suppliers and increasing overall demand for the products offered in the market (by extending the boundaries of economic activity). Thus, the process of creative destruction is built on dynamic, deliberate entrepreneurial efforts to change market structures and can be propitious for additional innovations and profit opportunities. Based on the concept of creative destruction, Schumpeter formulated his theory of long waves of business cycles and economic growth. Business cycles are seen as the result of innovation, which consists of the generation of a new idea and its implementation in a new product, process or service, leading to the dynamic growth of the national economy, the increase of employment, and creation of pure profit for the innovative enterprise.

While developing economies grow as standard economic growth models predict (through the accumulation of human and physical capital and increasing specialization), once an economy has entered the industrialized phase of capitalist development, a qualitative change in the drivers of economic growth occurs. In advanced industrial economies, growth is driven by the process of technological advance and knowledge accumulation brought about by R&D efforts of firms (Peretto 1999).

Schmitz presents a model in which entrepreneurial activity is a key determinant of productivity growth. In his model Schmitz focuses in particular on the role of imitative activities of entrepreneurs in economic growth. This focus is motivated by the growth experience of numerous economies, suggesting that it is less the innovating entrepreneur *à la* Schumpeter than the imitating entrepreneur who contributes to growth.

Imitating entrepreneurs are entrepreneurs who imitate existing activities and put them into practice, thereby often creating knowledge through a process that Schmitz characterizes as learning by implementing (Schmitz 1989).

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3.10 THE EMPIRICAL APPROACH

There are various strands in the empirical literature on entrepreneurship and economic growth using different measures of entrepreneurial activity. For instance, while one strand of empirical studies measures entrepreneurship in terms of the relative share of economic activity accounted for by small firms, other studies use data on self-employment, the number of market participants (competition) or firm start-ups as an indicator of entrepreneurial activities.

Together with recent studies on OECD countries, the analyses of the Global Entrepreneurship Monitor (GEM) represent one of the most important sources for statistical analysis of the links between entrepreneurial activity and economic growth. The GEM is a research programme launched in 1999 that provides annual assessments of the national level of entrepreneurship. GEM analyses are based on a harmonized assessment of the level of national entrepreneurial activity for all participating countries and represent one of the rare sources of data on entrepreneurship conducive to cross-country comparison. The GEM measures national entrepreneurial activity as the share of people among a country's labour force who are either actively involved in starting a new venture and/or manage a business less than 42 months old. In its latest report (2002), the GEM shows that *the national level of entrepreneurial activity has a statistically significant association with subsequent levels of economic growth.* GEM data also suggests that *there are no countries with high levels of entrepreneurship and low levels of economic growth.*

Until now, the GEM data have had to be viewed with caution. It can, however, be assumed that an analysis of more countries over a longer period of time will accumulate evidence of a positive link between high rates of entrepreneurship and economic growth.

This assumption is supported by a variety of other empirical studies using different indicators of entrepreneurial activity. Nickell (1996) and Nickell, Nicolitsas and Dryden (1997) examine, for instance, the effect of market competition, measured as an increase in the number of competitors in relation to the development of companies' productivity performance. An increase in the number of competitors is a possible measure of entrepreneurship, since the introduction of a new product or the start-up of a new firm is an entrepreneurial act. Using data from around 600 UK manufacturing firms from the periods 1972–86 and 1982–94, the authors find evidence that competition, or an increase in the number of competitors, has a positive impact on total factor productivity growth.

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Caree and Thurik (1998), who examine how the share of small firms affects subsequent industry output growth, have likewise established positive effects between this measure of entrepreneurship and growth. Basing their study on a sample of 14 manufacturing industries in 13 European countries, the authors investigated whether or not a higher share of small business at the beginning of the 1990s led to higher output growth in subsequent years in European manufacturing. The results of their study indicate that industries with a high share of small enterprises relative to the same industries in other countries performed better in terms of output growth during the subsequent 3-4 years.

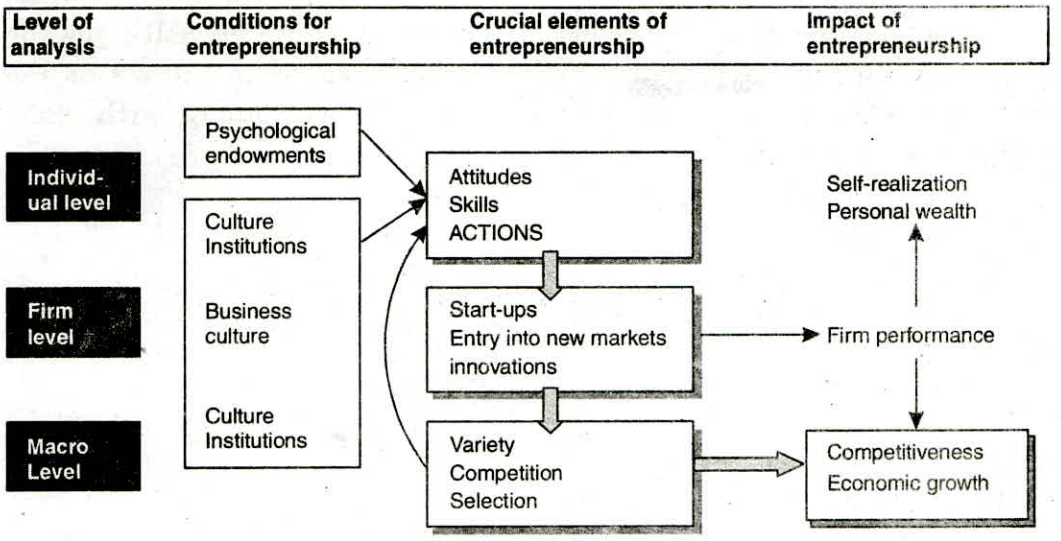
This evidence suggests an increase in the importance of entrepreneurship as a feature of the economy, often referred to as the transformation from a "managed" to an "entrepreneurial" economy. The transformation to an "entrepreneurial economy" occurred between the mid-1970s and early 1990s and becomes evident in a change in industry structure shifting economic activity away from large enterprises to smaller entities, in particular to Small and Medium-Sized Enterprises (SMEs).

The growing number of SMEs and increasing outsourcing by large firms are a reaction to greater dependence on flexibility and knowledge as factors of production brought about by technological change and the intensification of global competition. Smaller business entities appear to be better suited to cope with the conditions of increased globalization, since they show higher flexibility and propensity to innovation and are an outstanding vehicle for channeling the entrepreneurial ambitions of individuals.

In addition, the outsourcing strategies of large established firms go hand in hand with a new emphasis on "intrapreneurship" (entrepreneurial behaviour within an existing company), which is considered essential to competitive success (OECD 1998: 35). The increasing importance of entrepreneurship as a result of these developments is best expressed in the words of Michael Porter: "Invention and entrepreneurship are at the heart of national advantage" (Porter 1990: 125).

3.11 CONCEPTUAL FRAMEWORKS TO LINK ENTREPRENEURSHIP TO ECONOMIC GROWTH

Recently two established models have succeeded in *not* restricting explanations for economic growth to the realm of macroeconomics. The related framework models are proposed by Wennekers and Thurik (1999) and the GEM research programme. Wennekers and Thurik (1999) established the following model, relating entrepreneurial activity to economic growth:



Source: Carree and Thunk (2002): 20:

Fig. 3.1. *The Wennekers and Thurik Model*

The model distinguishes between three levels of analysis: the individual level, the firm level and the macro level. Entrepreneurial activity originates at the *individual level* and is always traceable to a single person, the entrepreneur. Entrepreneurship is, hence, induced by an individual's attitudes or motives, skills and psychological endowments.

Yet the individual entrepreneur is not undertaking entrepreneurial activities in a timeless and spaceless vacuum, but is affected by the context in which he or she is acting. Therefore, entrepreneurial motives and actions are influenced by cultural and institutional factors, the business environment and macroeconomic conditions.

While entrepreneurship originates at the individual level, realization is achieved at the *firm level*. Start-ups or innovations are vehicles for transforming personal entrepreneurial qualities and ambitions into actions. At the *macro level* of industries and national economies, the sum of entrepreneurial activities constitutes a mosaic of competing experiments, new ideas and initiatives. This competition leads to variety and change in the market – that is, a selection of the most viable firms, their imitation and a displacement of obsolete firms. Entrepreneurial activity hence expands and transforms the productive potential of the national economy by inducing higher productivity and an expansion of new niches and industries. Processes at the aggregate level are, in turn, linked to the individual layer, obviously including important feedback mechanisms for individual entrepreneurs. Entrepreneurs can learn from both their own and others' successes and failures, which enables them to improve their skills and adapt their attitudes.

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The conceptual framework of GEM takes a slightly different angle. It analyses the success of large firms advancing market opportunities for SMEs and the role of entrepreneurship in the enterprise creation/growth process as the main mechanisms driving macroeconomic growth along with their complementary nature.

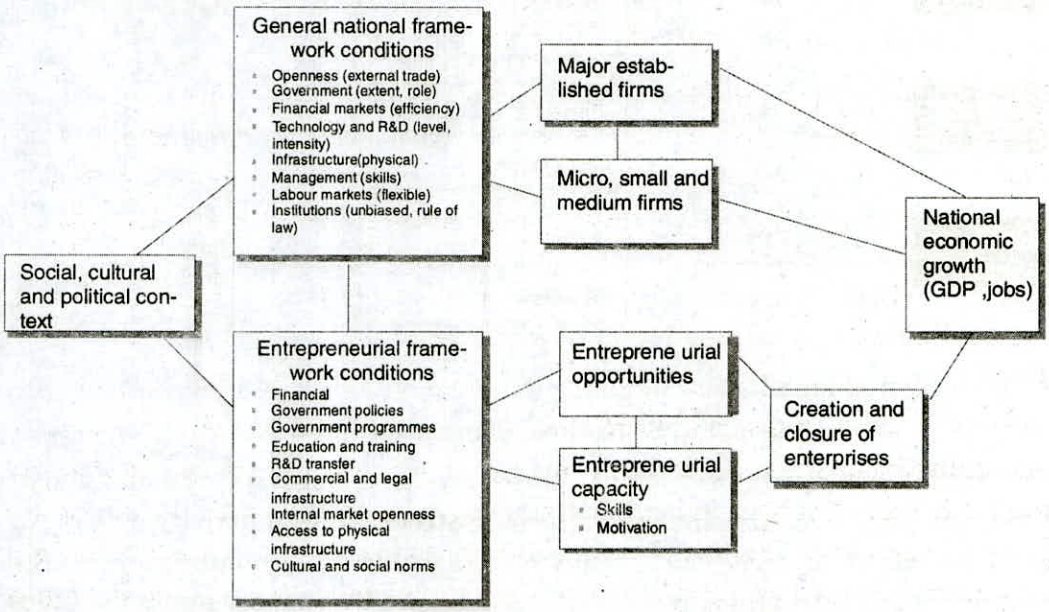

Fig. 3.2. *The GEM conceptual model*

The top portion of Fig. 3.2 focuses on the role of large established enterprises. Depending on national framework conditions, large firms, generally integrated into international trade markets, can promote self-expansion and maturation. The economic success of large enterprises tends to create new market opportunities for SMEs through technological spill-overs, spin -offs, an increase in domestic demand for goods and services, an integration of SMEs in supplier networks, and so forth. Yet whether domestic firms are able to seize these opportunities depends largely on the existence of a competitive and vibrant SME sector. The lower portion of Fig. 3.2 highlights the second mechanism driving economic growth: the role of entrepreneurship in the creation and growth of firms. The entrepreneurial process occurs in the context of a set of framework conditions.

It further depends on (*a*) the emergence and presence of market opportunities and (*b*) the capacity, motivation and skills of individuals to establish firms in pursuit of those opportunities. While the success of large established enterprises tends to create profit opportunities for small and new firms, these firms can also affect the success of large enterprises. For instance, by being competitive and reliable suppliers, SMEs provide a competitive advantage for large firms in global arenas.

3.12 MEANING AND DEFINITION OF SMALL SCALE INDUSTRY

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The definition of small scale industry varies from one country to another and from one time to another in the same country depending upon the pattern and stage of development, government policy and administrative set up of the particular country.

There are at least 50 different definitions of SSI's found and used in 75 countries. In some of the countries of the world the criterion for defining small enterprise is related to the size of employment. For example in USA a small enterprise is one which has employment of 500 people. In UK it is less than 20 skilled labours, in Germany, less than 300 and in Italy less than 50 people. However, in most of the countries the definitions of SSI are related to either investment or size of employment or both.

The definition of small scale industry is an important aspect of government policy as it identity the target groups. The first official criterion for small scale industry in India dates back to second five year plan when it was in terms of gross investment in land, building, plant, machinery and the strength of the labour force. On the recommendation of the Federal Association of Small Industries of India (FASI), only the investment in fixed assets in plant and machinery, whether held in ownership terms or by lease or hire purchase, is considered instead of fixing the limit on overall investment in plant and machinery. The evolution of legal concept of SSI is given in the Table 3.6. An ancillary unit is one which sells not less than 50% of its manufacturers to one or more industrial units.

However for small scale industries, the planning commission of India uses the terms village and cottage industries. These include modern small-scale industries and the traditional cottage and house-hold industries as shown in Fig. 3.3.

Table 3.6

1950	The fiscal commission for the first time defined an SSI as one which is operated mainly with hired labour usually 10 to 15 hands.
1954–55	The Government of India set up Central Small Scale Industries Organization (CSSIO) and Small Scale Industries Board (SSIB) to promote small scale industries.
1960	Employment criterion to define SSI was dropped and under investment criterion an industry having gross value of fixed asset up to Rs. 5 lakhys was called as SSI.

1975	The investment limit was rise to ₹ 10 Lakhs (15 Lakhs for ancillary units).
1980	The investment limit was rise to ₹ 20 Lakhs (25 Lakhs for ancillary units).
1985	The investment limit was rise to ₹ 35 Lakhs (45 Lakhs for ancillary units).
1995	The investment limit was rise to ₹ 60 Lakhs (75 Lakhs for ancillary units).
March 1997	The investment limit was raised top ₹ 3 Crore.
1999–2000	The investment limit was reduced to 1 Crore
2007	Limit is 1 Crore only.

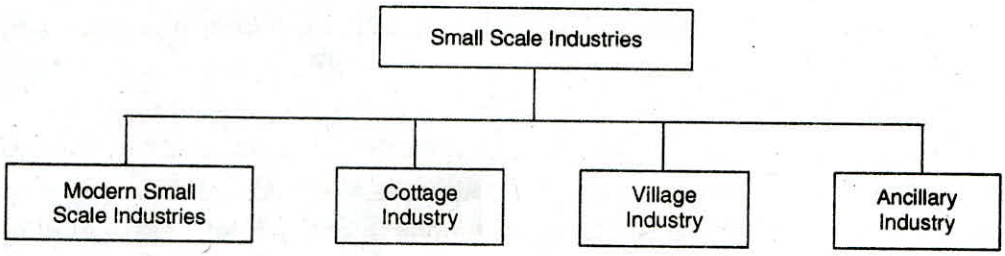

Fig. 3.3 *Types of small-scale industries*

3.13 CHARACTERISTICS OF SSI

The following are the characteristics of SSI

1. A small unit is generally a one-man show. Even if SSI is run on partnership or company, the activities are carried by one of the partners or directors; the others are as sleeping partners.
2. In case of SSI, the owner himself or herself is a manager also and hence an SSI is managed in a personalized fashion. The owner takes effective participation in all matters of business decision making.
3. The scope of operation of SSI is generally localized, catering to the local and regional demands.
4. The gestation period *i.e.,* the period after which return on investment starts is relatively lower when compared to large units.
5. SSI's are fairly labour intensive with comparatively smaller capital investment.

6. Small units use indigenous resources and therefore, can be located anywhere subject to the availability of these resources like raw materials, labour etc.
7. Using local resources Small Units are decentralized and dispersed to rural areas. Thus small units promote balanced regional development and prevent the influx of job seekers from rural areas to cities.
8. Small scale units are more change susceptible and highly reactive and receptive to socio-economic conditions. They are more flexible to adopt changes like introduction of new products, new method of production, new materials, new markets and new form of organization etc.

3.14 RATIONALE

Emphasizing the very rationale of small-scale industry in the Indian economy, the Industrial Policy Resolution (IPR) 1956 stated:

"They provide immediate large scale employment, they offer a method of ensuring a more equitable distribution of the national income and they facilitate an effective mobilization of resources of capital and skill which might otherwise unutilized. Some of the problems that unplanned urbanization tends to create will be avoided by the establishment of small centers of industrial production all over the country".

The rationale of small scale industries so established can broadly be classified into four arguments as discussed below:

1. ***Employment Argument:*** In view of abundant labour and scarce capital resources, the most important argument in favor of the SSI's that have a potential to create immediate large scale employment opportunities. There are many research findings available which will establish that smallscale units are more labour intensive than large units. Small units use more of labour per unit than investment. Studies have shown that the output-employment ratio is the lowest in small sector, employment generating capacity of small sector is eight to ten times that of large scale sectors. Some scholars oppose this argument. They are of the opinion that employment should not be created for the sake of employment. According to them it is not how to absorb surplus resources but how to make the best use of scarce resources. Then employment argument becomes output argument.
2. ***Equality Argument:*** An important argument in favor of small-scale industries is that they ensure a more equitable distribution of national income and wealth. This is based on two major considerations:

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(*i*) Compared to ownership of large scale units, the ownership of small-scale units is wide spread.

(*ii*) Their more labour-intensive nature and decentralization and dispersal to rural and backward areas provide more employment opportunities to the unemployed.

Most of these small-scale units are proprietary or partnership concerns, the relations between workers and employers are more harmonious in small-scale units than in large-scale units.

Dhar and Lydall do not agree this argument and give statistical evidence that wages paid to workers in small-units are much lower when compared to the workers in large industries. Workers in small enterprises due to non-existence of trade unions are unorganized and therefore are easily exploited by the employers. But in an underdeveloped country like India, even if small-scale units provide low paid jobs, they would be of virtual importance in our economy where millions are already in search employment to eke-out their livelihood.

3. ***Decentralization Argument:*** Big industries are concentrated every where in urban areas, but small industries can be located in rural or semi-urban areas to use local resources and to cater to the local demands. Hence it promotes balanced regional development in the country. Though it is not possible to start small-scale industry in every village, but it is quite possible to start small units in a group of villages. Decentralization will help tap local resources, idle savings, and local talents and improves the standard of living even in erstwhile backward areas. The good example of this phenomenon is the economy of Punjab which has more small-scale units than even the industrially developed state of Maharashtra.

4. ***Latent Resource Argument:*** According to this argument, small enterprises are capable of mapping up latent and unutilized resources like hoarded wealth and ideal entrepreneurial ability etc. Dhar and Lydall feel that the real source of latent resources argument lies in the existence of entrepreneurial skill. According to them there is no evidence of an overall shortage of small entrepreneurs in India. Hence they doubt the force of this latent resource argument. Their assertion does not appear to be very sound simply because of the fact that if small entrepreneurs were present in abundance, then what obstructed the growth of small enterprises? The emergence of entrepreneurial class requires a conducive environment. The impressive growth in the number of small enterprises in the post independent period highlights the fact that, providing the necessary conditions such as power and credit facilities, the latent resources of entrepreneurship can be tapped by the growth of small enterprises only.

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3.15 OBJECTIVES

The various objectives of developing small-scale industries are in fact, implied in one way or other, in its rationale itself. However, an attempt has been made in this section to enumerate the main objectives of developing small enterprises in India.

1. To generate immediate and large scale employment opportunities with relatively low investment.
2. To eradicate unemployment problem from the country.
3. To encourage dispersal of industries to all over country covering small towns, villages and economically lagging regions.
4. To bring backward areas too, in the main stream of national development.
5. To promote balanced regional development in the whole country.
6. To ensure more equitable distribution of national income.
7. To encourage effective mobilization of country's untapped resources.
8. To improve the standard of living of people in the country.

3.16 SCOPE

The scope of small-scale industries is quite vast covering a wide range of activities. These activities are characterized by labour intensive, need less capital and require less sophisticated technology. The activities which are found particularly amenable can be successfully operated in small scale are too many to mention. Among them the important ones are:

- Manufacturing activities
- Servicing/repairing activities
- Retailing activities
- Financial activities
- Whole-sale business
- Construction activities
- Infrastructural activities like transportation, communication etc.

In order to strengthen the scope for small-scale industries, the Government of India has announced reservation policy for small sector in the country. In 1967 only 47 items were reserved for exclusive manufacture in small scale sector. In 1983 the reserved list included 836 items. Later Abid Hussain committee dereserved 12 items and thus there are 824 items in the reserved list. The objective of this reservation policy is to insulate the small sector

from unequal competition of large industrial establishments, so that the small firms can grow through expansion of existing units and the entry of new firms. Some of the important items reserved for exclusive development in the small sector are food and allied industries, textile products, leather and leather products, foot wares, plastic and rubber products, chemical and chemical products, glass and ceramics, pressure stove, electrical appliances, boats and truck body building, auto parts components, bicycle parts, tricycles, survey instruments, sports goods, stationery items, clocks and watches etc.

It is also important to note that the performance of reserved small-scale industries does not outshine that of non-reserved small industries. J.C. Sandesara, has found that the easy entry into SSI sector has intensified competition within the sector, and resulted in excess supply, and thus, a fall in profitability. He also adds that the reservation policy is calculated to keep 'infant' industry in a permanent state of infancy. However the main objective of reservation policy has been insulated small sector from unequal competition of powerful large scale units, so that the small sector can grow through expansion on one hand, and by the entry of new firms on the other hand seems to be achieved. Examples are many to support this view.

3.17 ROLE OF SSI IN ECONOMIC DEVELOPMENT

Economic development is defined in a number of ways; the commonest definition could be 'an increase in real per capita income of a person resulting in improvement in the levels of living'. The developments of small-scale industries contribute to the increase in per capita income. The role of SSI in economic development is given below.

1. ***Employment:*** SSI use labour intensive techniques and therefore provide employment on a large scale, SSI accounts for 75% of the total employment in the industrial sector. SSI provides self-employment to artisans, technically qualified persons and professionals. These industries also offer employment to farmers when they are idle.
2. ***Optimization of Capital:*** SSI requires less capital per unit of output and provides quick returns on investment due to shorter gestation period. Small scale units help to molatise small and scattered savings and channelise them into industrial activities.
3. ***Balanced Regional Development:*** SSI promotes decentralized development of industries. They help to remove regional disparities by industrializing rural and backward areas. They also help to improve the standard of living in suburban and rural areas.
4. ***Mobilization of Local Resources:*** SSI helps to mobilize and utilize local resources like small saving, entrepreneurial talent etc. which might

otherwise remain idle and unutilized. These industries facilitate the growth of local entrepreneurs and self-employed professionals in small towns and villages.

5. ***Export Promotion:*** SSI helps in reducing pressure on the country's balance of payments in two ways. First they do not require imports of sophisticated machinery or raw materials. Secondly, SSI can earn valuable foreign exchange through exports. There has been a substantial increase in exports from the small scale sector.
6. ***Consumer Surplus:*** SSI now produces a wide range of mass conception items. Over 5000 products are being manufactured in small scale sector. About one-half of the output of manufacturing sector in India comes from small scale industries.
7. ***Feeder to Large Scale Industries:*** SSI plays a complementary role to large scale sector. They provide parts, components, accessories etc., to large scale industries. They serve as ancillary units.
8. ***Social Advantage:*** Small scale sector contributes towards the development of a socialistic pattern of society by reducing concentration of income and wealth. They provide an honorable and independent living to people with limited resources. They facilitate wide participation of public in the process of development.
9. ***Share in Industrial Production:*** SSI contributes more than one-half of the total industrial production in India. About 5000 products are manufactured in the small scale sector.
10. ***Development of Entrepreneurship:*** Small scale units have helped to develop a class of entrepreneur. These units facilitate self-employment and spirit of self-reliance in the society.

3.18 ADVANTAGES OF SMALL SCALE INDUSTRIES

- Small scale enterprises can be started as per convenience of the owner in terms of space, finance, product and manpower.
- The setting up of the unit and starting of production requires a small gestation period of only 2 to 6 months and layout can be made as per convenience.
- Locally available skilled and semi-skilled people can be appointed at short notice and at a much lower wages compared to the medium and large industries.
- Wherever high technology involved the parent company executives will help. Alternatively, consultants can be hired to sort out technology related problems.

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- It is one of the best forms of self-employment as well as giving employment opportunities to own kith and kin, friends and relatives etc.
- In case of rural sector the SSI units will be able to have cheaper labour especially in off seasons.
- In developing countries the SSI units are a necessity to assist bigger industries and new projects. Thus they not only contribute to the economy of the nation but also create employment opportunities to people around the project sites.
- In case of SSI units started by experienced and talented executives, there is abundant scope to develop high technology components for MNCs and also to organize exports.
- Due to increase in population there has been increase in production of consumer goods and Fast Moving Consumer Goods (FMCG). In view of this there is a bigger role for small industries to take up components production and even manufacture the product itself.
- The small units are exempted from excise duty up to 75 lakhs per annum turnover. In case of industries in the backward districts, waiver or concession is given for various statutory taxes. Thus lot of paper work and formalities are avoided.
- Since employees are recruited based on contacts or relations there will be loyalty to the owner and hence there will be no trade union activity.

3.19 STEPS TO START AN SSIS

Starting an SSI is a complex job. The potential entrepreneur has to pass through a number of steps in a step-by-step approach to achieve his goal of setting up an SSI. In fact, deciding and motivating the self is the first bedrock upon which the establishment concept of an enterprise is entirely posited. Similarly, the identification of a viable project ensures the proposition that "well begun is half done". Hence the various steps involved in establishment of an enterprise through which the entrepreneur may pass are the following:

1. ***Decision to be Self-Employed*:** This is the most crucial decision a youth has to take, shunning wage employment and opting for self-employment or entrepreneurship.
2. ***Analyzing Strengths, Weaknesses, Opportunities and Threats (SWOT Analysis)*:** The potential entrepreneur has to analyze his strengths, weaknesses, opportunities and threats, while deciding to go for entrepreneur career. This analysis enables him to know what type

and size of business would be the most suitable. This will vary from person to person.

3. ***Scanning of Business Environment*:** It is always essential on the part of the entrepreneur to study and understand the prevailing business environment. In order to ensure success of his enterprise, entrepreneur should scan the business opportunities and threats in the environment. He should study the administrative framework, procedures, policies, rules and regulations and other formalities implemented by the government.
4. ***Training*:** Before going to start the enterprise, the potential entrepreneur must assess his own deficiencies which he can compensate through training. He can avail the facilities of various training institutes like EDI, NIESBUD, IEDs existing in our country. These institutes are providing tailor-made Entrepreneurship Development Programmes (EDPs) and skill up gradation training programmes for the benefit of the new entrepreneurs, existing entrepreneurs and for the employees of the small scale industries.
5. ***Product Selection*:** The most important step is to decide what business to venture into, the product or range of products that shall be selected for manufacture and in what quantity. The level of activity will help in determining the size of business and thus form of ownership. One could generate as many project ideas as one can through environment scanning and short list a few of them as discussed in the last unit. Closely examine with the help of opportunity analysis each one of them and zero on the final product or products.
6. ***Market Survey*:** It is always convenient to manufacture an item but difficult to sell. So it is rational on the part of the entrepreneur to survey the market thoroughly before embarking upon production. Market survey implies systematic collection of data by the entrepreneur about the product for manufacture, demand-supply lag, extent of competition, frequency of demand, pattern and design of demand, its potential share in the market pricing, distribution policy, etc. The principle is to produce what actually people demand. The entrepreneur can contact the concerned authorities for this, and will be discussed later.
7. ***Form of Organization*:** A firm can be constituted as proprietorship, partnership, limited company (public/private), cooperative society, etc. This will depend upon the type, purpose and size of entrepreneur's business. One may also decide on the form of ownership on the basis of resources at hand or from the point of view of investment.
8. ***Location*:** The next step will be to decide the location where the unit is to be established. Will it be hired or owned? The size of plot, covered and open area and the exact site will have to be decided.

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9. ***Technology***: To manufacture any item, technology is used. Information on all available technologies should be collected by the entrepreneur and the most suitable one to be identified. This will also be useful to determine the type of machinery and equipment to be installed. The entrepreneur can contact DIC, TCO etc.

10. ***Machinery and Equipment***: Having chosen the technology, the machinery and equipment required for manufacturing the chosen products have to be decided, suppliers have to be identified and their costs have to be estimated. One may have to plan well in advance for machinery and equipment especially if it has to be procured from outside the town, state or country.

11. ***Project Report Preparation***: After deciding the form of the ownership, location, technology, machinery and equipment, the entrepreneur should be ready to prepare his project report or the feasibility study. The economic viability and the technical feasibility of the product selected have to be established through a project report. A project report that may now be prepared will be helpful in formulating the production, marketing, financial and management plans. It will also be useful in obtaining finance, shed, power connection, water connection, raw material quotas, etc. The entrepreneur has to consider the guidelines given by the Planning Commission in preparing the report.

12. ***Project Appraisal***: Ordinarily, project appraisal implies the assessment of a project. It is a technique for ex-ante analysis of a scheme or project. While preparing to set up an enterprise, the entrepreneur has to carefully appraise the project from the standpoint of economic, financial, technical, market, managerial and social aspects to arrive at the most socially-feasible enterprise. To avail the finance from the financial institutions and banks, a comprehensive appraisal of projects carrying techno-economic feasibility aspects should be undertaken by the entrepreneur. Thus, a project which is selected should be technically feasible and economically viable, and then only it will be bankable. For this, the following appraisals can be performed at the preliminary level:

    (*a*) Economical appraisal

    (*b*) Financial appraisal

    (*c*) Technical appraisal

    (*d*) Management appraisal

    (*e*) Organizational appraisal

    (*f*) Operational appraisal

    (*g*) Market appraisal

13. ***Finance*:** Finance is the lifeblood of the enterprise. Entrepreneur has to take certain steps and follow specified norms of the financial institutions and banks to obtain it. A number of financial agencies provide capital assistance and venture capital for starting an enterprise. There are some agencies which provide financial assistance on concession rates. Under PMRY and REGP schemes financial assistance and subsidies are being provided to the persons who want to set up their own enterprise.
14. ***Provisional Registration*:** It is always worthwhile to get the unit registered with the government. The entrepreneur has to obtain the prescribed application form for provisional registration from DIC or Directorate of Industries. After having duly filled in the application form, he has to submit the application with all relevant documents in the local DIC or Directorate of Industries. This will enable the entrepreneur to avail various government facilities, incentives and assistances schemes including financial assistance from NSIC/SFCs/ KVIC.
15. ***Technical Know-How*:** In some cases, technical know-how may be arranged for setting up enterprise. This can be arranged through TCOs, NSIC, SSIDC, DIC, private consultants, SISI, ED-institutes, foreign collaborators, India Investment Centre, and Industry, etc. Facilities are also available to SSI for making technical know-how arrangements including turn-key jobs.
16. ***Power and Water Connection*:** The sites, where the enterprise will be located, should either have adequate power connections or this should be arranged. Entrepreneur can calculate the total power requirement and determine the nearest pole from which power will be given to the enterprise as it can materially affect the installation cost. Similarly, the water connection will have to be obtained or provision should be made for adequate water supply to the firm.
17. ***Installation of Machinery:*** Having completed the above formalities, the next step is to procure the machinery for installation. Machinery should preferably be installed as per the plan layout.
18. ***Recruitment of Manpower*:** Once machines are installed, the need for manpower arises to run them. So the quantum and type of manpower is to be decided. This presupposes the skilled, unskilled and semiskilled labour, administrative staff etc. Further, sources of getting desired labour and staff members be indented and recruited. Possibly, the labour force has to be trained either at the entrepreneur's premises or in a training establishment.
19. ***Procurement of Raw Materials*:** Raw materials are the important ingredients for running an enterprise. The labour will require raw

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materials to work upon the installed machinery. These materials may be procured indigenously or may have to be imported by the entrepreneur. Entrepreneur has to identify the cheap an assured sources of supply of raw materials for running his own enterprise. Government agencies. (See Table 3.7) can assist in case the raw materials are scarce or imported.

20. ***Production***: The unit established should have an organizational set-up. To operate optimally, the organization should employ its manpower, machinery and methods effectively. There should not be any wastage of manpower, machinery and materials. If items are exported, then the product and its packaging must be attractive. Production of the proposed item should be taken up in two stages:

    (*i*) Trial production

    (*ii*) Commercial production

    Trial production will help tackling problems confronted in production and test marketing of the product. This will reduce the chances of loss is the eventuality of mistakes in project conception. Commercial production should be commenced after the test-marketing of the product.

21. ***Marketing***: Marketing is the most important activity as far as the entrepreneurial development is concerned. Various aspects like how to reach the customer, distribution channels, commission structure, pricing, advertising, publicity, etc., have to be decided by the entrepreneur. Like production, marketing should also be attempted cautiously, that is, in two stages namely:

    (*i*) Test stage

    (*ii*) Commercial marketing stage

    Test marketing is necessary to save the enterprise from going into disrepute in case the product launched is not well accepted by the customers. It will also assist the entrepreneur in carrying out modifications or additions in designs and features of the product. Having successfully test marketed the product, commercial marketing can be undertaken. The entrepreneur can contact the Small industries marketing corporation.

22. ***Quality Assurance***: Before marketing, the product quality certification from BIS (Bureau of Indian Standards)/AGMARK/HALLMARK, etc., should be obtained depending upon the product. If there is no quality standards specified for the products, the entrepreneur should evolve his own quality control parameters. Quality, after all, ensures long term success.

23. ***Permanent Registration:*** After the small scale unit goes into production and marketing, it becomes eligible to get permanent registration based on its provisional registration from DIC or Directorate of Industries.

24. ***Market Research:*** Once the product or service is introduced in the market, there is strong need for continuous market research to assess needs and areas for modification, upgradation and growth. Market becomes waterloos for most SSI entrepreneurs as they ignore the vital day-to-day operation. Initial success should not lure the entrepreneur into a sense of complacency.

Table 3.7: Sources of information

S. No.	*Area*	*State Level Agencies*	*National Level Agencies*
1.	Project selection	SISI, DIC, IDC's, IIC's, TCO's, SFSs, SIC, IC, IEB, PTC	CB, SIDO, CSIR, DEP, IIC, IFCI, IPB, NRDC, EDI
2.	Registration and licenses	CIF, DDCA, DIC, EB, GMD, SIC, WPCB, IC, LA, STC, TC	CECD, CCIE, ISI, IDC, MIC, NSIC, RC, RT, SC, DGTD
3.	Finance	DIC, Bank, SFC, SIC, IICs, IDCs	CB, CEC, ICICI, IDBI, IFCI, NISC, SBI, DIC
4.	Technical	DDCA, DIC, DJCII, TOCs, GMD	CIPET, CSIR, IIC, IIFT, MRDC, NSIC, RT, SBS, SISI, CITD, ICMR
5.	Training	EDPs, SISI, TCDs, DICs	SBI, CB, CIPET, IRL, NISIET, IITs, NISBUT, EDI
6.	Infrastructure facilities	DIC, EB, IDC, LA	–
7.	Raw materials	DIC, MID, MDC, SIC, IC, STC	CCIE, MMTC, MDC, SPC
8.	Plant and machinery	DIC, IIC, SFC, SEC, IC, IDB	CCIE, NSIC, SISI
9.	Marketing information	DIC, TCO's, SEC, SIC, RIMCO	DEP, DGSD, CCIE, IIFT, MID, SIC, ICMR, ICAR

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Table 3.8: Application forms

S. No.	Subject	Agencies
(A)	**Planning Stage**	
1.	Provisional registration number	DIC
2.	Application for shed or plot	SIDC
3.	No objection certificate from ideal authorities	LA (Local Authority)
4.	No objection certificate from health department	District health officer
5.	No objection certificate from electricity department	Electricity department
6.	Loan application for term loan	SFC/NB/NSIc
7.	Subsidy registration	DIC
8.	Application for building plan and estimates	Approval of architect contractor
9.	Application for bank account/cash credits/ working capital loan	NB
10.	Application for air and water pollution no objection certificate	State pollution control authority
11.	Application for the approval of production programme for certain restricted items	DIC, SISI, Central Ministry
12.	Registration of partnership deed	Registrar of firms
13.	Application for ancillary units	Parent companies
14.	Registration of firms	Register of firms
15.	Application for the boilers and plant layout of the unit	Inspector of Boilers
16.	Application for the production of petroleum based product	Ministry of Petroleum
17.	Application for Excise Registration Number	Excise Department
18.	Application for Latex in rubber based products	Rubber Board

19.	No objection certificate from Forest Department for wood based products	State conservation of forests
20.	Applications for essential commodity items as raw materials	District Civil Supply Department
21.	Application for imported raw materials	DIC/Export-Import Boards
22.	Application for imported of machines	DIC/Export-Import Boards
23.	Application for raw materials quota	D/C/Export-Import Boards
(B)	**During Implementation of Project**	
24.	Application for power connection	Local Electriicty Dept.
25.	Application for water	LA
26.	Application for C-Form (Sales Tax)	Sales Tax Department
27.	Application for state Sales Tax Registration	Sales Tax Department
28.	Application for central Sales Tax Registration	Sales Tax Department
29.	Application for exemptions from Sales Tax	DIC/Sales Tax Deptt.
30.	Application for exemption from Octrol Duty	DIC/LA
31.	Application for stonng of inflammable raw material	Director of Explosives
(C)	**During Running of Enterprise**	
32.	Application for Permanent Registration Number	DIC/Dirctorate of Industries
33.	Application for subsidy claims	DIC
34.	Application for powr subsidy	LA
35.	Application for food preservation ordinance license	Food Controller
36.	Application for registration in case of more than 20 employees without power use or more than 10 employees with power use.	Labour Welfare Board/ Employment Exchange/ P.F. Commissioner
37.	Application for product marketing to the Central Government Department	DIC/DGSD

3.20 GOVERNMENT POLICY: INDUSTRIAL POLICY RESOLUTIONS

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Major Environment

After attaining independence in 1947, India adopted economic planning as a method to achieve economic development. The pattern of planning that came to be accepted was of a mixed type meaning thereby that industrial units in the public and private sector will be operating in the economy. The mixed nature of the economy meant that on crucial areas the policy of the government was decisive and changes therein were in great relevance to industrial units. In the field of industry, government's objectives and intentions were announced through five Industrial Policy Resolutions (IPRs). These resolutions were announced in 1948, 1956, 1977, 1980 and 1990 (for a summary, see table 11.4). We shall briefly state what each of the IPRs had stated about growth and development of SSI sector. It must be added that it is only recently that government policy and activities of the different interface institutions have covered SSE in addition to SSI. The earlier thinking was mostly addressed to SSI.

IPR 1948

The industrial sector in 1948 was not different from the one existing in pre-1947 days and hence the SSI sector meant mainly rural industrial units, small job-cum-repair shops, units making agricultural implements, a few urban small units and handloom units weaving clothe. The greatest economic significance of these units to the Indian economy was their employment potential. It was this potential which called for protection through policy and the main thrust of IPR 1948 as far as the small scale sector was concerned was **protection**.

IPR 1956

The second IPR was announced against the background of a bolder Second Five ear Plan, with a long term strategy for industrial and economic development. As to the SSI sector, the resolution envisaged a dual role viz. (i) manufacture of consumer goods such as clothe and (ii) manufacture of components for the newly established industry as part of the programme for long term industrial development. Thus, to the earlier emphasis of protection was added development. Industrial Policy for SSI aimed at **"Protection plus development"**. IPR 1956 in a manner initiated the modern SSI in India.

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IPR 1977

The next IPR was announced after a lapse of two decades. During the preceding decades, two major problems had been witnessed. First was the lopsided industrial development—large, medium and small scale industries had become more of an urban phenomena and the other was large scale unemployment—the issue of urban and rural, educated and uneducated unemployed had started becoming difficult.

This situation led to a renewed emphasis on promotion of typical employment generating small scale industry, located in rural areas and small towns. As a formula it was: scale of output should be small, location semi urban/rural and technology, labour intensive. This was the IPR which assigned a positive role to SSI in terms of wage employment of worker and self-employment of the entrepreneur. This was the IPR which therefore, offered a wider perception to policies and programmes for SSI development. To the earlier thrust of protection (IPR 1948) development (IPR 1956) this resolution added promotion. The SSI sector was thus, to be **protected, developed and promoted.**

IPR 1980

This IPR re-emphasized the spirit of the IPR 1956 with its strategy of large scale, high technology and heavy investment based key or basic industry. Nevertheless, the SSI sector remained as perhaps the best sector for generating wage and self-employment based opportunities in India.

IPR 1990

This IPR was announced during June 1990. Its basic aim is to introduce measures of economic liberalization and simplified rules and procedures with a view to enhancing the technological base of industry and accomplishing higher levels of output. It gave a special emphasis on the SSI/SSE sector where employment opportunities are likely to be high. In order to enable the SSI units to update their technology the investment limit of SSI has been raised to ₹ 60 lakhs.

SSI Policy Framework—Latest Amendment

In line with new economic policies, a policy document for SSI was announced on 6th August 1991.

- It continued priority sector lending to SSI by Banks/Financial Institution.
- Excise exemption scheme
- Reservation of items for exclusive production
- Price and purchase preference
- Uniform package of incentives of the entire sector

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It introduced new measures like:

- Removal of location restrictions
- Enhancement of coverage, limits
- Shift towards infrastructural development support
- Inclusion of services in this sector
- Allowing equity investment in SSI (up to 24%)
- Shift from protection/regulation to promotion of equality, technology and efficiency
- Substantial de-regulation and simplification of rules and procedures.

Table 3.9: Industrial policy resolution: a summary

Year	*Main Objective*	*Principal Measure*	*The SSI Universe*
IPR 1948	Protection	Raw material cheap power technical advice, marketing of products, Safe-guarding against excessive competi-tion from large units.	Village-based small enterprises Repairs-cum-job shops Units using local market, raw materials, labour. Hence locally self-sufficient
1956	Protection plus development	Protect artisan based non-tech. enterprise development. Modern SSI for Industrial and consumer goods. Provide capital and skill. Develop export based units. Achieve regional balance through SSI. Package of assistance and incentives infrasturcture, technological upgradetion Reservation of items for SSI.	Tiny/cottage rural units. Modern SSI units in urban areas. Units employing labour inten-sive technology. New entrants to SSI-new entrepreneurs. Ancillary units, Moidern SSI.
1977	Protection plus development plus promotion	Proect labour intensive technology. Promote small tiny units, promote non-urban location, promote new first generation entreprenerus, decentralized production.	– do –
1980	Protection plus development plus promotion	Protect labour intensive technology. Promote small tiny units, promote non-urban location, promote new first generation entrepreneurs decentralized production, nuclear plant for SSI growth, reservation products for SSI.	– do –

1990	Promotion of equality, technology and efficiency	Promotion of SSI and agro based industries reservation of products 836 and new lines to be identified. Central investment subsidy-rural and backward areas. Technology centers for modernization. Small industry Development Bank (SIDBI). Facilities of KVIC and KVI boards to be expanded to help artisans in marketing. Agro-processing industry to receive high priority.	– do –

3.21 GOVERNMENT SUPPORT TO SSI DURING FIVE YEAR PLAN

Immediately after independence, government of India has given great importance to the development of small-scale sector in the successive five year plans. The expenditures for SSI during the eight Five Year Plans are given in table 3.10.

First Plan: In the first five year plan ₹ 48 crores (constituting 47.8% of total plan expenditure on industry) was spent on small-scale sector alone. During this plan six boards were constituted namely All India Handloom Board, All India Handicraft Board, All India Khadi and Village Industry Board, Small-Scale Industries Board, Coir Board and Central Silk Board. The Boards were established to cover the entire field of small-scale and cottage industries.

Second Plan: As per the recommendations of Karve Committee, the second Five Year Plan focused on dispersal of industries. During this plan 60 industrial estates were established for providing basic facilities like water, power, transport etc. at one place. The total expenditure during this plan towards SSI was ₹ 187 crores. In addition some items were reserved for exclusive production in small-scale industries.

Third Plan: The third Plan focused on extension of coverage of small scale industries. During this plan ₹ 248 crores were spent.

Fourth Plan: The programmes adopted during the third plan were extended during fourth plan also. As a result, small-sector witnessed significant diversification and expansion during the fourth plan period, during which 346 industrial estates had been completed and small-scale sector provided employment to almost 82,700 persons.

Fifth Plan: The main thrust of the fifth plan was to develop small-scale

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industries to remove poverty and inequality stacking the land. During this plan the expenditure incurved is ₹ 592 crores.

***Sixth Plan*:** Because of the massive development programmes initiated for the development of promising small-scale sector, the actual expenditure of ₹ 1945 crores surpassed the plan 836 items were reserved for manufacturing in small-scale industries and reserved 409 items for exclusive purchase from small scale industries. In addition, SIDO (Small-Industries Development Organization) was established to provide consultancy services in technical, managerial and marketing. In 1982 CART (Council for Advancement of Rural Technology) was established for providing necessary technical input to 23 rural industries. By the end of sixth plan, the production from small and cottage industries increased to ₹ 65,730 crores, exports touched ₹ 557 crores and employment in SSI sector reached 315 lakh persons. This accounts for 80% of the total industrial employment.

***Seventh Plan*:** The main thrust of this plan was upgradation of technology to increase competitiveness of small sector. The new watch word was "competition" and "not reservation".

The actual expenditure of ₹ 3,249 crores surpassed the plan outlay of ₹ 2,752 crores. The value of production increased from ₹ 57,100 crores to ₹ 91,681 crores.

***Eighth Plan*:** The main thrust of the eighth plan was the employment generation as the motive force for economic growth. To achieve this, small and village industries have been assigned an extremely important role. The proposals of this plan are (i) The plan reiterated that timely and adequate availability of credit is more important than concessional credit. For this purpose SIDBI was established, certain new initiatives like sanction of composite loans under 'single window system', concessional loans to state corporations for infrastructural developments were introduced. (ii) Eighth plan proposed to establish tool room and training institutes in order to upgrade technology. (iii) Growth centre approach has been accepted and 70 growth centers were established. In addition establishment of functional industrial estates with agricultural and horticulture products was also proposed. (iv) Proposed to establish integrated infrastructure development centers for tiny units. For this the centre, the state governments and industry associations were also involved.

Table 3.10: Expenditure towards SSI in five year plans

Plan/Period	*Total Expenditure Towards SSI (in Crores)*
First (1951–56)	48.00
Second (1956–61)	187.00
Third (1961–66)	248.00
Fourth (1969–73)	242.00
Fifth (1974–78)	592.00
Sixth (1980–85)	1,945.00
Seventh (1985–90)	3,249.00
Eighth (1992–97)	6,334.00

3.22 NEW POLICY INITIATIVES IN 1999-2000 FOR SMALL SCALE SECTOR

The government of India has announced new policy initiatives for small-scale sector in 1999-2000. The features of new policy are listed below.

1. A national programme for Rural Industrialization has been announced, with a mission to set up 100 rural clusters every year, to give a boost to rural industrialization.
2. To coordinate the latest development with regard to the World Trade Organization (WTO), a cell has been set up in the office of DC (SSI) to disseminate information to SSI Associations and SME units, regarding recent developments, prepare policies for SSIs in tune with the WTO agreements and organizing WTO sensitization seminars, workshops.
3. Cotton yarn has been included in the general excise exemption scheme for SSIs.
4. Small job workers, engaged in printing of glazed tiles, have been exempted from excise duty.
5. Announcement of a new credit insurance scheme in the Budget (1999-2000) for providing adequate security to banks and improving flow of investment credit to SSI units, particularly export oriented and tiny units.
6. The working capital limit for SSI units is determined by the banks on the basis of 20 percent of their annual turnover. The turnover limit for this purpose has been enhanced from ₹ 4 crore to ₹ 5 crore.
7. To increase the reach of banks to the tiny sector, tending by banks of Non-Banking Financial Companies (NBFCs) or other financial intermediaries for purpose of on lending to the tiny sector, has been

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included within the definition of priority sector for bank lending.

8. Exemption from excise duty, as given to SSI units, will be extended to goods bearing a brand name of other manufacturers in rural areas.
9. The investment limit for small scale and ancillary undertakings has been reduced from existing ₹ 3 crores to ₹ 1 crore.

3.23 IMPACT OF GLOBALIZATION AND LIBERALIZATION ON SSI

Before the introduction of new economic reforms in 1991 following the inevitable globalization, the SSI sector was overprotected. The small-scale industry never had a strong desire to grow to medium and large scale because of the benefits of protection given to it. Many of the policies also discouraged the growth of small scale units into large ones and had a stunting effect on manufacturing, employment and output growth.

With the globalization, the SSIs are now exposed to sever competition both from large-scale sector, domestic and foreign and MNCs. The effect of globalization can be summarized as below.

1. The new policies of the government towards liberalization and globalization without ensuring the interest or priority of small-scale sector resulted in poor growth rate of SSI sector. The SSI sector has suffered because of the lending institutions and promotional agencies, whose main agenda is to serve big units and multinationals.
2. The problems of SSI in liberalized environment have become multidimensional delay in implementation of project, inadequate availability of finance and credit, marketing problems, cheap and low quality products, technological obsolescence, lack of infrastructural facilities, deficient managerial and technical skills, to name some.
3. Globalization resulted in opening up of markets, leading to intense competition. For example, the World Trade Organization (WTO) regulates multilateral trade, requiring its member countries to remove its import quotas, restrictions and reduce import tariffs. India was also asked to remove quantitative restrictions on import by 2001 and all export subsidies by 2003. As a result every enterprise in India whether small-scale or large scale has to face competition. The process was initiated for small-scale units by placing 586 of its 812 reserved items on the open general license list of imports.
4. With the removal of restrictions of foreign direct investment, multinational

companies entered India which further intensified the competition in the domestic market. The 1990's witnessed the entry of multinational companies in areas such as automobiles, electronics and IT based sectors.

In the changed environment after globalization and liberalization, the policies and projects for the SSI sectors will have to be effective and growth oriented (not just protecting) so as to achieve competitiveness.

In order to protect, support and promote small enterprises, a number of protective and promotional measures have been undertaken by the central government. The promotional measures cover the following:

- Industrial extension services
- Institutional support in respect of credit facilities
- Provision of developed sites for construction of sheds
- Provision of training facilities
- Supply of machinery on hire purchase terms
- Assistance for domestic marketing as well as exports
- Special intensive for setting up enterprises in backward areas
- Technical consultancy and financial assistance for technological upgradation.

3.24 IMPACT OF WTO/GATT ON SSI

The challenges to the small-scale sector are due to the impact of agreements under WTO. The setting up of the WTO in 1995 has altered the framework of international trade towards non-distortive, market oriented policies. This is in keeping with the policy shift that occurred world wide in favour of the free market forces and tilt away from state regulation/intervention in economic activity. This is likely to lead to an expansion in the volume of international trade and changes in the pattern of commodity flows.

The main outcome of WTO stipulated requirements will be brought about through reduction in export subsidies, greater market access, removal of non-tariff barriers and reduction in tariffs.

There will also be tighter patent laws through regulation of intellectual property rights under Trade-Related Intellectual Property Rights (TRIPS) Agreements, which laid down what is to be patented, for what duration and on what terms. Increased market access to imports will mean opening up the domestic market to large flows of imports. The removal of quantitative restrictions on imports of these items will soon be freed from all restrictions as announced in the recent import-export policy. Increased market access will also mean that our industries can compete for export markets in both

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developed and developing countries. But the expected surge in our exports can come about only if SSI sector is restructured to meet the demands of global competitiveness, which is the key to the future of small industries in present contest.

SSIs have to face threats and also avail opportunities owing to the WTO and its agreements. The main opportunities of the WTO are classified into three. Firstly, national treatment of exportable items across the countries all over the world, with better market access through the internet. Second, enlightened entrepreneurs have greater opportunities to benefit from their comparative advantages due to lowering of tariffs and dismantling of other restrictions. Finally, industries that are in constant touch with government, which in turn negotiates in their best interests in the on-going dialogue with the WTO, are going to benefit. India has real chance of becoming superpower in the service sector, particularly IT. It has already captured about 25 percent of world exports.

3.25 SUPPORT

Meaning and Need for Support

Finance is one of the essential requirements of any line of activity. Before actually setting up their units, small entrepreneurs need to know very clearly about the type and extent of their financial requirements. Integral to financial requirements is to know about the possible alternative sources from which finance can be availed of. Given the shortage of own funds, the Government of India as a part of its policy of promotion of small-scale sector in the country, has set up a host of institutions to meet the financial requirements of small entrepreneurs.

Starting an industrial unit require various resources and facilities. Small scale enterprises, given their small resources, find it difficult to have these own. Finance has been an important resource to start and run an enterprise because it facilitates the entrepreneur to procure land, labour, material, machine and so on from different parties to run his/her enterprise. Hence finance is considered as "life blood" for an enterprise. Recognizing it, the Government through her financial institutions and nationalized banks, has come forward to help small entrepreneurs provide them funds. Admittedly, finance is an important resource but not the only condition to run an enterprise. In order to start any economic activities, a minimum level of prior built up of infrastructural facilities is needed. Financial assistance and concessions cannot, in any case, adequately compensate for the deficiencies of infrastructure such as transport and communication. This is one of the

reasons why industries have not been developing in backward areas in spite of financial assistance and concessions given by the Government to the entrepreneurs to establish industries in backward areas. Creation of infrastructural facilities involves huge funds which the small entrepreneurs do lack. In view of this, various central and state government institutions have come forward to help small entrepreneurs in this regard by providing them various kinds of support and facilities. Availability of institutional support helps make the economic environment more conducive to business or industry. The various kinds of support and facilities provided are discussed in the next section.

3.26 AGENCIES OF GOVERNMENT FOR SSI

The ministry of small-scale industries is the administrative ministry in the Government of India for all matters relating to small scale and village industries which designs and implements policies and programmes for promotion and growth of small industries. The Department of small-scale industries was created in 1991, in the Ministry of Industry to exclusively formulate the policy framework for promoting and developing small-scale industries in the country. It initiates appropriate policy measures, programmes and schemes for promotion of SSI. The policy measures include setting up of a network of institutions to render assistance and to provide a comprehensive range of services and common facilities for SSIs. The range of services cover consultancy in techno-economic and managerial aspects, training, testing facilities, and marketing assistance through the agencies created for the specified functions. These activities are supported by a host of other central/ state government departments, promotional agencies, autonomous institutions, non-government organizations and so on.

The implementation of policies, programmes and schemes for providing infrastructure and support services to small enterprises is undertaken through its attached office, namely Small Industries Development Organization (SIDO), Khadi Village and Industry Commission (KVIC) and Coir Board, National Small Industry Corporation (NSIC) and various training institutes. The institutional network can be broadly classified as under and is shown in Fig. 3.4.

(1) Central level institutions/agencies

(2) State level institutions/agencies

(3) Other agencies

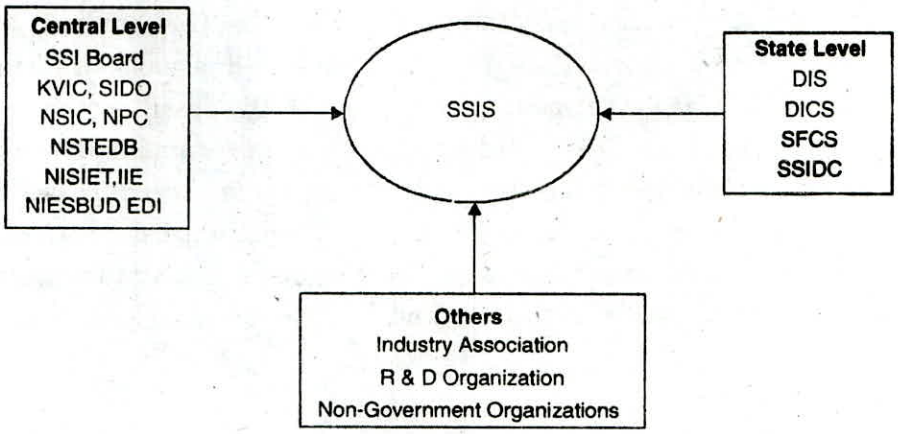

Fig. 3.4. *Institutions supporting small-scale industries*

3.27 NATURE AND TYPES OF SUPPORTS

Policy Support

1. The investment limit for the tiny sector will continue to be ₹ 25 lakh.
2. The investment limit for the SSI sector will continue to be at ₹ 1 crore.
3. The ministry of SSI and ARI will bring out a specific list of hi-tech and exportoriented industries which would require the investment limit to be raised upto ₹ 5 crore to admit suitable technology upgradation and to enable them to maintain their competitive edge.
4. The Limited Partnership Act will be drafted quickly and enacted. Attempt will be made to bring the bill before the next session of parliament.

Fiscal Support

To improve the competitiveness of small-scale sector the exemption for excise duty Limit rose from ₹ 50 lakhs to ₹ 1 crore.

1. The composite loans limit rose from ₹ 10 lakh to ₹ 25. lakh.
2. The Small-Scale Service and Business (Industry Related) Enterprises (SSSBES) with a maximum investment of ₹ 10 lakhs will qualify for priority lending.
3. In the National Equity Fund Scheme, the project cost limit will be raised from ₹ 25 lakh to ₹ 50 lakh. The soft loan limit will be retained it 25 percent of the project cost subject to a maximum of ₹ 10 lakh per project. Assistance under the NEF will be provided at a service charge of 5 percent per annum.

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4. The eligibility limit for coverage under the recently launched (August, 2000) Credit Guarantee Scheme has been revised to ₹ 25 lakh from the present limit of ₹ 10 lakh.
5. The Department of Economic Affairs will appoint a Task Force to suggest revitalization/restructuring of the State Finance Corporations.
6. The Nayak Committee's recommendations regarding provision of 20 percent of the projected turnover as working capital is being recommended to the financial institutions and banks.

Infrastructure Support

1. The Integrated Infrastructure Development (IID) Scheme will progressively cover all areas in the country with 50 percent reservation for rural areas.
2. Regarding upgrading Industrial Estates which are languishing, the Ministry of SSI and ARI will draw up a detailed scheme for the consideration of the planning commission.
3. A plan scheme for cluster Development will be drawn up.
4. The Funds available under the non-lapsable pool for the North-East will be used for Industrial Infrastructure Development, setting up of incubation centers, for cluster Development and for setting up of IIDs in the North-East including Sikkim.

Technological Support and Quality Improvement

1. Capital subsidy of 12 percent for investment in technology in selected sectors. An Inter-ministerial committee of Experts will be set up to define the scope of technology upgradation and sectorial priorities.
2. To encourage Total Quality Management, the scheme of granting ₹ 75,000/- to each unit for opting ISO-9000 Certification will continue for the next six years *i.e.,* till the end of the 10th plan.
3. Setting up of incubation centers in Sunrise Industries will be supported.
4. The TBSE set up by SIDBI will be strengthened so that it functions effectively as a Technology Bank. It will be properly networked with NSIC, SIDO (SENET programme) and APCTT.
5. SIDO, SIDBI and NSIC will jointly prepare a compendium of available technologies for the R & D institutions in India and Abroad and circulate it among industry associations for the dissemination of the latest technology related information.
6. Commercial banks are being requested to develop schemes to encourage investment in technology upgradation and harmonize the same with SIDBI.

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7. One-time capital grant of 50 percent will be given to Small-Scale Associations which wish to develop and operate Testing Laboratories, provided they are of international standard.

Marketing Support

1. SIDO will have a Market Development Assistance (MDA) programme, similar to one obtaining in the Ministry of Commerce and Industry. It will be a plan scheme.
2. The vendor Development Programme, Buyer-Seller meets and Exhibitions will take place more often and at dispersed locations.

Informational Support

(1) General information.

(2) Technical/Marketing expertise in specific areas.

(3) Technical and financial expertise.

(4) Implementation assistance for turn-key projects.

Incentives and Subsidies

(1) Export-import subsidies.

(2) Interest free loans.

(3) Subsidy for R & D work.

(4) Capital investment subsidy.

(5) Transport subsidy.

(6) Interest subsidy.

(7) Subsidy for power generation.

(8) Exemption from property tax.

(9) Incentives for NRI.

(10) Exemption from income tax.

(11) Sales tax exemptions.

(12) Price preference to SSIs.

(13) Subsidy/assistance for technical consultancy.

(14) Exemptions from stamp duty.

(15) Provisional for seed capital.

(16) Allotment of controlled or subsidized raw materials.

(17) Subsidy for cost of market study/feasibility study or reports.

Other Types of Support

(1) Streamlining Rules and Regulations.

(2) Entrepreneurship development training.

(3) Rehabilitation of sick units.

3.28 ANCILLARY, TINY AND SERVICE INDUSTRIES

An ancillary unit is one, which sells not less than 50% of its manufactures to one or more industrial units. The limit of investment is same for ancillary units and smallscale industries. The investment limit for tiny industry is ₹ 25 lakh in plant and machinery. There is no restrictive condition of the location of the unit in small towns. These enterprises would be entitled to preference in land allocations, power connection, access to facilities or skill/ technical upgradation. These would also have easy access to institutional finance, priority in Government purchases and relaxation in labor laws.

Service units provide services such as hotel and hospital services. The investment ceiling is fixed at ₹ 1.0 million (excluding land and buildings).

In India a small-scale industry is defined as an industry having gross value of fixed asset in plant and equipment up to ₹ 1 crore. The characteristics of SSI are one man show, scope of operation is generally localized, low gestation period, fairly labour intensive and generally makes use of local resources. The rationale of SSI can be broadly classified into employment argument, equality argument, decentralization argument and latent resource argument. SSI plays a crucial role in economic development. An entrepreneur has to follow a step-by-step procedure to start an enterprise right from identification of opportunities. The Government's objectives and intensions towards SSI were announced through her five Industrial policy Resolutions (IPR). The main thrust of IPR 1948 was protection, in IPR 1956 it was protection plus development, in IPR 1977 the focus was on protection, development and promotion. The IPR 1990 focus was on promotion of equality, technology and efficiency. In 1991 new economic policies were announced.

The Government of India has given great importance for the development of smallscale sector in the successive five year plans. The total expenditure towards SSI in first five year plan was ₹ 48 Crore and in the eighth five year plan total expenditure towards SSI was ₹ 6334 Crore. Globalization, Liberalization, WTO and GATT have impact on SSIs, both positive and negative. The agencies of the Government to be contracted are classified as State and central Government agencies. These agencies provide financial support, technical support and marketing support etc.

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3.29 NATIONAL SMALL INDUSTRIES CORPORATION (NSIC)

The National Small Industries Corporation (NSIC), an enterprise under the union ministry of industries was set up in 1955 in New Delhi to promote aid and facilitate the growth of small scale industries in the country. NSIC offers a package of assistance for the benefit of small–scale enterprises.

1. ***Single Point Registration*:** Registration under this scheme for participating in government and public sector undertaking tenders.
2. ***Information Service*:** NSIC continuously gets updated with the latest specific information on business leads, technology and policy issues.
3. ***Raw Material Assistance*:** NSIC fulfils raw material requirements of small-scale industries and provides raw material on convenient and flexible terms.
4. ***Meeting Credit Needs of SSI*:** NSIC facilitate sanctions of term loan and working capital credit limit of small enterprise from banks.
5. ***Performance and Credit Rating*:** NSIC gives credit rating by international agencies subsidized for small enterprises up to 75% to get better credit terms from banks and export orders from foreign buyers.
6. ***Marketing Assistance Programme*:** NSIC participates in government tenders on behalf of small enterprises to procure orders for them.

3.30 SMALL INDUSTRIES DEVELOPMENT ORGANIZATION (SIDO)

SIDO is created for development of various small scale units in different areas. SIDO is a subordinate office of department of SSI and ARI. It is a nodal agency for identifying the needs of SSI units coordinating and monitoring the policies and programmes for promotion of the small industries. It undertakes various programmes of training, consultancy, evaluation for needs of SSI and development of industrial estates. All these functions are taken care with 27 offices, 31 SISI (Small Industries Service Institute) 31 extension centers of SISI and 7 centers related to production and process development.

The activities of SIDO are divided into three categories as follows:

(*a*) Coordination Activities of SIDO

1. To coordinate various programmes and policies of various state governments pertaining to small industries.

2. To maintain relation with central industry ministry, planning commission, state level industries ministry and financial institutions.
3. Implement and coordinate in the development of industrial estates.

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(b) Industrial Development Activities of SIDO

1. Develop import substitutions for components and products based on the data available for various volumes-wise and value-wise imports.
2. To give essential support and guidance for the development of ancillary units.
3. To provide guidance to SSI units in terms of costing market competition and to encourage them to participate in the government stores and purchase tenders.
4. To recommend the central government for reserving certain items to produce at SSI level only.

(c) Management Activities of SIDO

1. To provide training, development and consultancy services to SSI to develop their competitive strength.
2. To provide marketing assistance to various SSI units.
3. To assist SSI units in selection of plant and machinery, location, layout design and appropriate process.
4. To help them get updated in various information related to the small-scale industries activities.

3.31 SMALL INDUSTRIES SERVICE INSTITUTES (SISI)

The small industries service institutes have been set up in state capitals and other places all over the country to provide consultancy and training to small entrepreneurs both existing and prospective.

The main functions of SISI include:

1. To serve as interface between central and state government.
2. To render technical support services.
3. To conduct entrepreneurship development programmes.
4. To initiate promotional programmes.

The SISIs also render assistance in the following areas:

1. Economic consultancy/information/EDP consultancy.
2. Trade and market information.

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3. Project profiles.
4. State industrial potential surveys.
5. District industrial potential surveys.
6. Modernization and in plant studies.
7. Workshop facilities.
8. Training in various trade/activities.

3.32 SMALL SCALE INDUSTRIES BOARD (SSIB)

The government of India constituted a board, namely, Small Scale Industries Board (SSIB) in 1954 to advice on development of small scale industries in the country. The SSIB is also known as central small industries board. The range of development work in small scale industries involves several departments /ministries and several organs of the central/state governments. Hence, to facilitate co-ordination and inter-institutional linkages, the small scale industries board has been constituted. It is an apex advisory body constituted to render advice to the government on all issues pertaining to the development of small-scale industries.

The industries minister of the government of India is the chairman of the SSIB. The SSIB comprises of 50 members including state industry minister, some members of parliament, and secretaries of various departments of government of India, financial institutions, public sector undertakings, industry associations and eminent experts in the field.

3.33 STATE SMALL INDUSTRIES DEVELOPMENT CORPORATIONS (SSIDC)

(Karnataka State Small Industries Development Authority KSSIDC in Karnataka State) The State Small Industries Development Corporations (SSIDC) were sets up in various states under the companies' act 1956, as state government undertakings to cater to the primary developmental needs of the small tiny and village industries in the state/ union territories under their jurisdiction. Incorporation under the companies act has provided SSIDCs with greater operational flexibility and wider scope for undertaking a variety of activities for the benefit of the small sector. The important functions performed by the SSIDCs include:

- To procure and distribute scarce raw materials.
- To supply machinery on hire purchase system.

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- To provide assistance for marketing of the products of small-scale industries.
- To construct industrial estates/sheds, providing allied infrastructure facilities and their maintenance.
- To extend seed capital assistance on behalf of the state government concerned provide management assistance to production units.

3.34 DISTRICT INDUSTRIES CENTERS (DIC)

The District Industries Centers (DIC's) programme was started in 1978 with a view to provide integrated administrative framework at the district level for promotion of small scale industries in rural areas. The DIC's are envisaged as a single window interacting agency at the district level providing service and support to small entrepreneurs under a single roof. DIC's are the implementing arm of the central and state governments of the various schemes and programmes. Registration of small industries is done at the district industries centre and PMRY (Pradhan Mantri Rojgar Yojana) is also implemented by DIC. The organizational structure of DICS consists of General Manager, Functional Managers and Project Managers to provide technical services in the areas relevant to the needs of the district concerned. Management of DIC is done by the state government. The main functions of DIC are:

1. To prepare and keep model project profiles for reference of the entrepreneurs.
2. To prepare action plan to implement the schemes effectively already identified.
3. To undertake industrial potential survey and to identify the types of feasible ventures which can be taken up in ISB sector, *i.e.*, industrial sector, service sector and business sector.
4. To guide entrepreneurs in matters relating to selecting the most appropriate machinery and equipment, sources of it supply and procedure for importing machineries.
5. To provide guidance for appropriate loan amount and documentation.
6. To assist entrepreneurs for availing land and shed equipment and tools, furniture and fixtures.
7. To appraise the worthness of the project-proposals received from entrepreneurs.
8. To help the entrepreneurs in obtaining required licenses/permits/ clearance.

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9. To assist the entrepreneurs in marketing their products and assess the possibilities of ancillarization.
10. To conduct product development work appropriate to small industry.
11. To help the entrepreneurs in clarifying their doubts about the matters of operation of bank accounts, submission of monthly, quarterly and annual returns to government departments.
12. To conduct artisan training programme.
13. To act as the nodal agency for the district for implementing PMRY (Prime Minister Rojgar Yojana).
14. To function as the technical consultant of DRDA in administering IRDP and TRYSEM programme.
15. To help the specialized training organizations to conduct Entrepreneur development programmes.

In fine DIC's function as the torch-bearer to the beneficiaries/entrepreneurs in setting up and running the business enterprise right from the concept to commissioning. So the role of DIC's in enterprise building and developing small scale sector is of much significance.

3.35 TECHNICAL CONSULTANCY SERVICES ORGANIZATION OF KARNATAKA (TECSOK).

TECSOK is a professional industrial technical and management consultancy organization promoted by the government of Karnataka and other state level development institutions way back in 1976. It is a leading investor-friendly professional consultancy organization in Karnataka. Its various activities are investment advice, procedural guidance, management consulting, mergers and acquisition, process reengineering studies, valuation of assets for takeovers, impact assessment of socio-economic schemes, critical infrastructure balancing; IT related studies, detailed feasibility studies and reports. TECSOK with its pool of expertise in varied areas can work with new entrepreneur to identify a product or project. In addition to this TECSOK sharpens the project ideas through feasibility studies, project reports, market surveys, and sources of finance, selection of machinery, technology, costing and also providing turnkey assistance. To help entrepreneurs to face the global competition TECSOK facilitates global exposures, updated technology, market strategies, financial restructuring and growth to improve profitability of an industry.

TECSOK can identify sickness in existing industry and facilitate its turn around. TECSOK has expertise in rehabilitation of sick industries by availing rehabilitation packages offered by the government and financial institutions.

In addition it offers expert professional services to various institutions and departments of the state and central government. TECSOK undertake the assignment in the field of

- Technical and market appraisal of projects.
- Industrial potential surveys.
- Fact-finding and opinion reports.
- Corporate planning.
- Collection and collation of information.
- Impact assessment.
- Evaluation of schemes and programmes.
- Asset evaluation.
- Infrastructure development project proposal.
- Event management and publicity campaigns, and
- Organizing seminar and workshops.

TECSOK has over 25 well-experienced engineers in different disciplines, MBAs economists and finance professionals. It has business partnerships with reputed national and multinational consultants and out sources expertise for professional synergy. TECSOK has an exclusive women's cell which conducts training and education programmes, exhibitions for promotion of products and services provided by women entrepreneurs and offers escort services to women entrepreneur. TECSOK has many publications. "Kaigarika Varthe" a monthly is published by TECSOK. In addition it publishes "Guide to Entrepreneurs" "Directory of Industries" on a regular basis.

Focused Consultancy Areas of TECSOK

Promotion of Agro Based Industries: TECSOK is recognized nodal agency by the Ministry of Food Processing Industries, Government of India, for project proposal to avail grant and loan assistance under the special schemes.

Energy Management and Audit: Thrust is given to use non-conventional energy sources for which both state and central governments are offering incentives. TECSOK has been recognized as a body to undertake energy audit and suggest energy conservation measures. TECSOK undertakes studies and project proposal for availing assistance from the Indian Renewable Energy Development Authority (IREDA).

Environment and Ecology: TECSOK undertakes assignments relating to environment education, environment impact assessment, environment management plan and pollution control measures. TECSOK has joined hands with Karnataka Cleaner Production Center (KCPC) to provide total consultancy support in the area of environment.

Human Resource Development: TECSOK designs and organizes business development programmes, management development workshops, skill development programmes and in-house training packages. It undertakes programmes of empowerment of women entrepreneurs, organization of self-help groups. In order to encourage local entrepreneurs TECKSOK organizes awareness campaigns and motivation programmes in taluks and districts throughout Karnataka. Other TECSOK activities:

- Guidance in product selection and project identification.
- Market survey and market development advice.
- Consultancy for agro-based industries of a nodal agency of the government of India.
- Diagnostic studies and rehabilitation of sick industries.
- Environment impact assessment studies environment management plans and propagation of cleaner production techniques.
- Energy management and audit.
- Valuation of assets for mergers and takeovers.
- Infrastructure development project reports.
- Port tariff study and related areas.
- System study and software development.
- Management studies, company formation, corporate plan, enterprise restructuring etc.
- Designing and organizing training programme.

3.36 SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA (SIDBI)

For ensuring larger flow of financial and non-financial assistance to the small scale sector, the government of India set up the Small Industries Development Bank of India (SIDBI) under Special Act of Parliament in 1989 as a wholly owned subsidiary of the IDBI. The SIDBI has taken over the outstanding portfolio of the IDBI relating to the small scale sector. The important functions of IDBI are as follows:

- To initiate steps for technological upgradation and modernization of existing units.
- To expand the channels for marketing the products of SSI sector in domestic and international markets.

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

The SIDBIs financial assistance to SSIs is channeled through existing credit delivery system comprising state financial corporations, state industrial development corporations, commercial banks and regional rural banks. In 1992-93 it has introduced two new schemes. The first is equipment finance scheme for providing direct finance to existing well-run small-scale units taking up technology upgradation/modernization and refinance for resettlement of voluntarily retired workers of NTC. The other new scheme was venture capital fund exclusively for small-scale units, with an initial corpus of ₹ 10 crore. SIDBI also provides financial support to National Small Industries Corporation (NSIC) for providing leasing, hire-purchase and marketing support to the industrial units in the small-scale sector.

3.37 SUMMARY

- As discussed earlier, globalization in its current form has supported the greed factor.
- Global giants will not bother going to marginal or submarginal markets since they have to have large sales revenues. These markets do not offer such large revenues.
- Entrepreneurial activity is not likely to generate consumer value for everyone, but typically customer value for those who buy the product or the service generated by the entrepreneurs.
- The benefit to be generated by the proposed entrepreneurship can vary along the line of an opportunity spectrum.
- There are various strands in the empirical literature on entrepreneurship and economic growth using different measures of entrepreneurial activity.
- Entrepreneurial activity originates at the individual level and is always traceable to a single person, the entrepreneur.
- At the macro level of industries and national economies, the sum of entrepreneurial activities constitutes a mosaic of competing experiments, new ideas and initiatives.
- Emphasizing the very rationale of small-scale industry in the Indian economy, the Industrial Policy Resolution (IPR) 1956 stated.
- The scope of small-scale industries is quite vast covering a wide range of activities. These activities are characterized by labour intensive, need less capital and require less sophisticated technology.

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- Economic development is defined in a number of ways; the commonest definition could be 'an increase in real per capita income of a person resulting in improvement in the levels of living'.
- The National Small Industries Corporation (NSIC), an enterprise under the union ministry of industries was set up in 1955 in New Delhi to promote aid and facilitate the growth of small scale industries in the country.
- The small industries service institutes have been set up in state capitals and other places all over the country to provide consultancy and training to small entrepreneurs both existing and prospective.

3.38 REVIEW QUESTIONS

1. Explain the Globalization of the entrepreneurship.
2. What are the different advantages of Entrepreneurship?
3. Explain the Need for Entrepreneurship at the international level.
4. What are different Characteristics of Entrepreneurial Ventures?
5. Discuss the importance of the entrepreneur.
6. What do you mean by Small-Scale industry? List the characteristics of Small-scale industries.
7. Explain the rationale of SSI.
8. Enumerate the objectives of SSI.
9. Discuss the scope SSI.
10. Explain the role of SSI in economic development.
11. Discuss the advantages of SSI.
12. Explain in brief the steps involved in starting an SSI.
13. Explain the Government policy for SSI through five Industrial Policy Resolutions.
14. Discuss the Government's support to SSI during five year plans.
15. Explain the impact of Globalization and Liberalization on SSI.
16. Explain the impact of WTO and GATT on SSI.
17. Discuss agencies of Government for SSI.
18. Discuss the meaning and need of support.
19. Explain in brief the nature and types of support for SSI.
20. Discuss the support provided by NSIC to small scale industries.
21. Explain various activities of SIDO.
22. Explain the functions of SISI. Enumerate various types of assistances rendered by it.

23. **Discuss the important functions of SSIDC.**
24. **Explain in brief the main function of DIC.**
25. Discuss the various activities of TECSOK.
26. **Explain the focused consultancy areas of TECSOK.**

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3.39 FURTHER READINGS

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UNIT 4 THE PERSONAL ENTERPRISE ENVIRONMENT

★ STRUCTURE ★

4.0 LEARNING OBJECTIVES

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

- explain family and non-family entrepreneurship.
- differentiate between venture capital process and locating venture capitalists.

- define what is professionalism vs family entrepreneurs?
- discuss about the role of woman entrepreneur.
- describe the nature and overview.

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4.1 INTRODUCTION

We have seen that entrepreneurs are a heterogeneous group of individuals, and that the ventures they engage in are equally diverse. We have discussed the different degrees to which people exhibit entrepreneurial characteristics and the extent to which they exhibit entrepreneurial behaviour. We have suggested that encouraging enterprising behaviour is possible, that people can learn to be more enterprising, and that if they did so there would be a positive impact on both social and economic well-being. In this chapter we move on to consider the various barriers that individuals might encounter in engaging in entrepreneurial activity, and how they may be supported in overcoming these. In doing so we will consider a number of personal contexts (female entrepreneurship, ethnic minority entrepreneurship, and family businesses).

We will identify some of the perceived barriers and difficulties that these groups face, and explore the issues that are pertinent to their specific circumstances. We will also consider timing, perceived risk, and culture, and how these factors can influence the individual's decision to engage in entrepreneurial activity. Ultimately this choice is a personal one, and is very significant in the lives of the people concerned. The right type of support at the critical moment can be significant. For this reason we conclude by considering the nature of the support available (both public and private sector) and the extent to which it helps in overcoming the barriers to enterprise.

4.2 FEMALE ENTREPRENEURSHIP: ROLE OF WOMEN ENTREPRENEUR

Although women entrepreneurs have become a significant economic force in the UK, and rates of activity are catching up with those of men, the literature on **female entrepreneurship** is still relatively underdeveloped. When we look at studies into entrepreneurship there still appears to be a male bias in terms of the sample chosen and the examples given. Even when studies are conducted specifically on female entrepreneurs there is often a tendency to interpret the data in terms of male models, constructs and standards.

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Typologies

Goffee and Scase (1985) classified women entrepreneurs into four types, based upon two factors: their attachment to entrepreneurial ideals and their willingness to accept conventional gender roles.

Conventionals

This group are committed to both entrepreneurial ideals and conventional gender roles. In the main, they are working-class women with fragmented work histories forced into self-employment by economic necessity.

Innovators

Innovators are committed to entrepreneurial ideals but not to conventional gender roles. They tend to be professional women who choose self-employment as a solution to restricted career prospects.

4.3 DOMESTIC ENTREPRENEURS

This group have little attachment to entrepreneurial ideals but are strongly committed to conventional gender roles. They tend to fit their business duties around their family responsibilities.

4.4 FAMILY BUSINESSES

While a **family business** shares many of the problems that any business would, there are some unique aspects that are brought into sharp focus by the complexity of personal family relationships. While the individual circumstances of each and every family enterprise will be unique, these businesses often do face similar challenges.

Definitions

If we chose to adopt the broadest view, a family firm could be defined as any organization in which more than one member of a family is involved, or any organization that defines itself as a family business. Westhead and Storey (1997) argue that a family firm should meet at least three of the following four criteria:

- has undergone an intergenerational transition;
- has more than 50 per cent of the shares held by the family;

- has more than 50 per cent of family members involved in day-to-day management;
- speaks of itself as a family firm.

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Barclays Bank in their 2002 report on family businesses say that for a firm to be defined as a true family business, the family should hold a majority of the company's shares, and in the case of a public company, an individual family group must hold at least 25 per cent of the voting shares.

BDO Stoy Hayward similarly highlight ownership, management participation, and longevity in their definition:

- a single family holds more than 50 per cent of the voting shares;
- supplies a significant proportion of the company's senior management, and is effectively controlling the business;
- more than one generation is involved in the business; and most importantly;
- the family regards the business as a family business.

Incidence

According to the BDO Stoy Hayward Centre for Family Businesses up to 76 per cent of UK businesses are familyowned. Only 30 per cent of family businesses survive to the second generation and 15 per cent to the third, which highlights **succession planning** as one of the key issues for family businesses. Grant Thornton conduct an annual report on Family Businesses across Europe, and they also consistently highlight planning and succession issues as crucial.

Insularity

Family businesses can become quite insular in their approach, and bringing 'outsiders' into a firm is useful in that it offers an opportunity to introduce some fresh ideas and challenge some taken-for-granted assumptions. But doing this introduces some problems also. For example, should shares be made available to non-family members? This has implications for the way reward and remuneration packages are constructed. Taking 'outsiders' for the top jobs in a family business can put them in an impossible position. Expectations are often unrealistically high; they are unlikely to be able to produce the sort of magic that will be the key to an instant turnaround of fortunes if a business has been stagnating for a number of years, for example. It is also quite easy to unwittingly upset family sensitivities, although the fact that they are not aware of such sensitivities can be advantageous as their thinking is not constrained by the politics and they can often do what is not possible for family members.

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Conflicting Priorities

Personal relationships within families can impact upon the effectiveness of the business. For example, should the MD of a small firm put their personal feelings aside when faced with the choice of promoting their offspring over a non-family employee? The rational approach would be to choose the most able candidate, but irrespective of which candidate succeeds, interpersonal tensions arise. The son or daughter of the MD would face scrutiny of their performance, having to prove their capability, if they were chosen, and if they were not chosen the inevitable injuries to pride would (however temporarily) affect the relationship with the parent.

Issues like this are commonplace; they are not isolated occurrences. The ongoing psychological stress might also affect the ability of the owner to manage effectively.

Communication

Communication is often informal in families, but, as with any business, relying on informal communication can leave some people feeling that they are excluded or that they do not have an equal opportunity to express their views. Some members of the family, for example, might not actually work in the business but feel that they have a stake in it. In such circumstances there is an issue in relation to the level of influence that is appropriate in making decisions about the future of the organization.

Another common problem is the 'Sunday lunch decision-making' syndrome, where the family decides on what should be done outside the office (at the family Sunday lunch). The outsider, not having been invited to this informal gathering, is informed of what is going to happen on Monday morning! The opposite can also be true, when family disagreements take place 'on the shop floor' in front of staff, and sometimes (even worse) in front of customers.

Early Experience of Enterprise

The SBS 2003 Household Survey states that having an entrepreneur as a parent significantly increases the likelihood of an individual setting up their own business. Thirty-four per cent of 'doers' have a parent who is or has been an entrepreneur compared with about a quarter (26 per cent) of the general population. However, doers do not seem to have been influenced by any other relationship. They are not significantly more likely to have siblings or friends who have been or are entrepreneurs.

This might partly be genetic, but **early exposure to small business** seems to socialize children to be enterprising. Role models are very important as influencers and, in addition, the offspring of business owners often have ample opportunity to practise their skills by working in the family firm in

the evenings, at weekends and during holidays. Perhaps, having seen business management at first hand, children are also able to absorb learning informally.

Succession

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We would like to think that families are harmonious entities but this is not always true. There can be intergenerational differences in values, aspirations, and opinions as to how the business should be managed. For example, Lachlan Murdoch (who has long been regarded as his father's successor) recently resigned from the News Corp media empire, reportedly following a number of arguments with his father. His sister, Elisabeth, stepped down from Sky five years ago to set up her own television production company. Rupert Murdoch has made no secret of his wish for one of his children to take over the reins, but now only his younger son, James, remains in the family business. Similarly, the Pathak family were drawn into lengthy and acrimonious legal arguments when Anila Shastri and Chitralekha Mehta claimed that they were owed a share of the business empire founded by their father more than 40 years ago. Mrs Pathak said she and her husband, who died in 1997, never intended their daughters to own shares in the company.

When the daughters married they became the full responsibility of their husbands. However, the daughters argued that they were the victims of a Hindu culture in which male inheritance is still customary and women are treated unequally. Although the founders of the business might want to pass on the baton to the next generation, it does not necessarily follow that such an inheritance would be welcome. On the other hand the desire to inherit might be strong, but there are doubts in the current management about the successor's competence to run the organization effectively. Sometimes, the need to plan for succession is not recognized, or is not recognized in time. Planning for succession needs to begin well in advance. For example, if the plan is to sell the business, the timing of that sale might be crucial in terms of the general state of the market or the performance of the business.

BDO Stoy Hayward highlight a range of practical options for the founder, each of which bring their own advantages and disadvantages. They suggest that the founder can choose to:

- appoint a family member;
- appoint a caretaker manager;
- appoint a professional manager;
- liquidate the business;
- sell, in whole or in part;
- do nothing.

They point out that this decision will be influenced by:

- the availability of suitable family or non-family successors;
- the family's requirements from the business (for example whether funds need to be brought out of the business to support the founder in their retirement);
- the personal and corporate tax implications of the various options;
- the health and size of the business;
- the business environment at the time of succession.

The Small Business Service commissioned research into the Business Support and Policy implications of SME Ownership and Succession, which was published by the UCE Knowledge Management Centre in April 2002. This research concluded that the businesses most vulnerable to succession failure were where they:

- had lifestyle and personal, rather than strategic, goals;
- were performing poorly;
- were dependent upon the owner for day-to-day management;
- had no natural family or internal successor; or
- were ignoring the need to make arrangements for succession.

Part of the problem in planning succession is the former leader themselves. After spending so much of their life in a business, some entrepreneurs find it hard to accept that it is time to let go. Others are looking forward to taking the money and enjoying life. In Fig. 4.1 some stereotypical alternatives are identified, each having different consequences for the businesses they leave (or fail to leave) behind.

The monarch – They don't go easily. It takes a revolt or they diel
The general – they retire for a short time but then return to save the business.
The ambassador – these people go gracefully, often serve as mentors to others, and still act as ambassadors for the business.
The reborn entrepreneur – they start again somewhere else.
The hedonist – they take great holidays or play golf, finally indulging themselves.

Adapted from: Sommerfied and Spence, Family Business Review 2(4), Winter, 1989

Fig. 4.1. *What does the former leader do?*

Support Needs

Barclays (2002) found that when family businesses were asked what additional help they would like from the government, tax relief on succession was mentioned most frequently – one in four family business owners want support

in this area. Provision of loans, grants and subsidies, better advice and reduced business rates were also highlighted.

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4.5 YOUNG ENTREPRENEURS AND GREY ENTREPRENEURS

Young Entrepreneurs

Although there are many examples of successful **young entrepreneurs**, there are specific barriers that might hinder them in setting up in business, for example:

- lack of credibility;
- lack of experience and knowledge;
- lack of a network of contacts;
- lack of access to funds for start up.

The Prince's Trust is a UK charity that helps young people to realize their potential. In 2004 it helped 12 793 young entrepreneurs through its start up programme (www.princes-trust.org.uk). It offers a range of support including business advice, and small grants and loans to young people between the ages of 18 and 30 who are unemployed or work less than 16 hours per week.

Grey Entrepreneurs

In the year to September 2003, Office for National Statistics (ONS) figures show that the largest increase in self-employment came from **older entrepreneurs**. For full-time male entrepreneurs the group with the largest increase (86 000) were those aged 35–49, and a further 30 000 were aged 50–64. For part-time entrepreneurs these figures were 21 000 in the 50–64 age bracket and 9000 for age 65 and over. A similar pattern exists for women. Numbers of full-time self-employed women increased by 16 000 in the 35–49 age group and by 17 000 for those aged 50–59. Part-time women entrepreneur numbers grew by 18 000 in the 35–49 age group.

These people have often had considerable experience in their careers. Their motivations vary. Some are frustrated by the lack of opportunity and recognition within their employment; others are creative and innovative and leave employment or take early retirement to exploit opportunities. They have the advantage of specialist expertise, industry knowledge and contacts that they have developed over time.

Many also have considerable knowledge and experience of business management. They are at a stage in their lives where they may be more confident about their ability to manage their personal circumstances,

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sometimes having paid off mortgages and been relieved of familial responsibilities.

Environmental trends may also be part of the reason why there is a growth in 'grey entrepreneurship'. For example, some pension schemes have failed to provide the level of income that had been expected, leading to a need to generate additional income. Also, the flexibility of selfemployment might offer a tempting lifestyle where early retirement or redundancy has been offered.

4.6 INTRODUCTION TO VENTURE CAPITAL

Capital is the lifeblood of businesses. While no amount of money will make a bad business successful, no business can survive without enough money to develop products, hire employees, establish markets and attract customers. For many businesses, particularly in the early stages before profits become predictable, traditional sources of capital such as banks and credit unions are simply unavailable. For those businesses, venture capital may be the best hope to raise the money needed to succeed.

Today, there are more Maine-based venture capital firms than ever before. But while there is no shortage of capital, not every business can get the money it needs or wants. Venture capital is not the answer for all businesses in need of capital. But for those businesses that offer the potential of rapid growth and the potential for considerable profit, informed investors are ready to open their checkbooks.

These high growth businesses not only offer the prospect of substantial returns to owners and investors, they also create new jobs and strengthen the economy. The technology focus of many venture capital stage companies means that the jobs created tend to be relatively high quality jobs. Maine State Government has recognized the importance of supporting these next generation companies and has provided substantial resources to assist entrepreneurs in raising capital.

Maine entrepreneurs want to know whether venture capital is right for them, where to find it, and how to get it. This Primer on Venture Capital in Maine is designed to answer those questions. It explains what venture capital is (and is not), how venture capital investors work, what they are looking for, how to approach them, and what to expect when it comes time to structure an investment. In addition, the self-assessment will give entrepreneurs an idea of whether they are ready to seek venture capital. Venture capital typically comes from four generic sources:

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- Private venture capital firms
- Individual investors generally referred to as "angel investors"
- Corporations making strategic investments
- Governmental sources.

Angel investors have been making investments in Maine for many years without any formal tracking of their activity. The first formal venture capital firm in Maine, the Maine Capital Corporation, began operations in 1980.

4.7 WHAT VENTURE CAPITAL IS (AND IS NOT)?

The range of business investment opportunities that interest venture investors is quite broad and hard to precisely define. Simply stated, venture capital is money provided by individual investors or entities seeking a high return on their investment in privately owned business ventures. In order to get those high returns, venture investors are willing to accept a relatively high degree of risk of loss of their investment.

Generally speaking, the financial risk posed by a business venture corresponds with its stage of development, as shown in Fig. 4.2. Certainly there are mature businesses that are struggling and may present a high level of risk, but Fig. 4.2 summarizes the risk spectrum as it applies to most businesses:

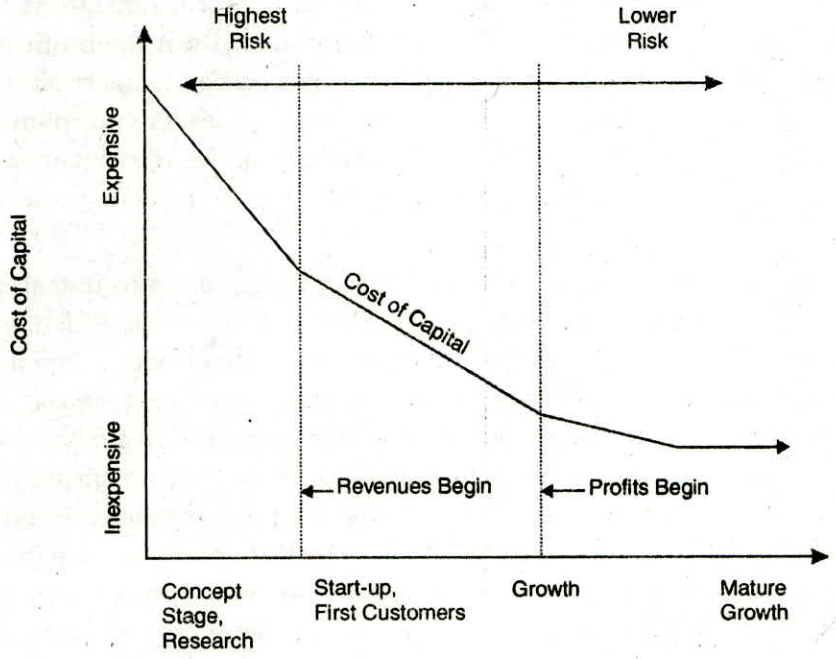

Fig. 4.2. *Cost of capital as a function of risk*

The highest risk level for a business is at its earliest stages (the left side of Fig. 4.2) before it has begun to generate much revenue. As businesses begin

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to sell products or services, expand, achieve breakeven cash flow and profitability, the level of risk of an investment in that business drops, moving to the right of Fig. 4.2.

As the risk declines, the cost of raising capital for the business declines also, as shown by Fig. 4.2. The cost of raising capital is the price the business must pay to get the capital it needs. It pays that price either in the form of a share of ownership in the business or through payments of interest, dividends, royalties, or other payments. Raising capital also gets easier as the risk level declines, especially once the business progresses to the point that banks become interested in lending it money.

Given a choice, entrepreneurs looking for money for their business will try to raise that capital at the lowest cost possible. Usually, the least cost option for a business is a loan from a bank or other commercial lender. These lenders look for an annual return that is typically in the range of about 5% to 12%, varying with changes in the Prime Rate of interest. Venture investors, on the other hand, look for annualized returns more in the range of 25% and up. So entrepreneurs looking for money will usually look for venture capital only if they do not have the choice of lower cost capital.

Banks and other lenders can offer comparatively low rates because they lend to companies that have a low risk of defaulting on their loans. Companies that present a low risk of default would be placed on the right side of Fig. 4.2. Some entrepreneurs complain that banks will only lend to businesses that do not need the money. The truth is that banks earn a comparatively small profit on the funds they lend; therefore, they cannot afford to make many bad loans. One bad loan may cost a bank more than the profit it makes on 25 good loans. Banks strive to keep their losses on bad loans to significantly less than 1% of their portfolios, so they lend to businesses that demonstrate the ability to repay the loan. Also, banks are looking for current income, and expect payments of interest, and usually principal as well, on a monthly basis.

Venture capital investors, on one hand, are willing to make investments in businesses that are too risky for banks; that is, companies which would be placed toward the left side of Fig. 4.2. Because higher risk means a greater ratio of bad investments to good ones, venture investors expect a much higher return on their successful investments to make up for the losses on their investments in companies that are not successful. Most venture investors do not expect to get regular payments, at least until the company is established and profitable. They look to make their profit down the road when the company is sold or when it issues stock to the public in an Initial Public Offering ("IPO"). Stated another way, venture investors look to participate in the increased value of a successful business venture, while banks and other lenders look to lend money for a fee and expect to receive regular payments regardless of changes in corporate value. Fig. 4.2 is a simplified way of

looking at the respective risk-reward tradeoffs applicable to venture capital investors and bank lenders:

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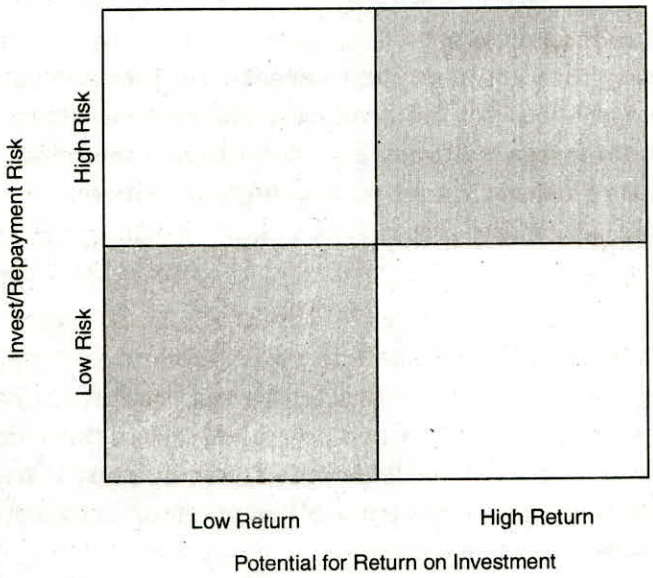

Fig. 4.3. *The risk/reward matrix*

Note that while venture capital investors invest in a high risk, high return environment (upper right quadrant) and banks lend in a low risk, low return environment (lower left quadrant), there are no capital sources in the high risk, low return quadrant. Venture capital is not the answer for all businesses that are unable to get a bank loan. Venture investors are not interested in taking a high degree of risk for a low return (upper left quadrant) and entrepreneurs are usually not willing to offer a high return on an investment with low risk (lower right quadrant) when they can probably get the money they need from a bank at a lower cost. Businesses in the center of the diagram or in the high risk, low return quadrant can sometimes find funds from friends and family. Or they may seek public sector sources of equity investments, "near equity" loans and loan guarantees provided by state and local governmental and nonprofit entities. However, these sources, while often weighing public benefit in their investment decision process, are still required to make prudent risk/return decisions in order to remain viable over the long term.

The fundamental question each entrepreneur should consider before pursuing venture capital is whether the potential for return to the investors is high enough to attract the investors' attention. For companies that have not yet generated any revenues or are less than a year or two old, most venture investors are not likely to be interested unless they see a potential to make at least five to ten times their investment over a five to seven year period. Producing that kind of return to investors usually requires two things: the company has to grow rapidly, and it has to successfully execute an "exit" or "liquidity event" to produce the cash the investors are looking for. To raise

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venture capital, an entrepreneur has to address these two issues and be able to show both the growth potential and the likelihood that the investment can be converted to cash within a reasonable time frame. Most investors are not interested in funding a "lifestyle" company, which to a venture capitalist means a company that can provide a decent living for the entrepreneur and his or her employees, but cannot produce an attractive return to the investor within a reasonable time frame. Fig. 4.4 further describes what venture capitalists can and cannot do when making investments.

There are three main types of "liquidity events" allowing investors to get the value of their investment out of the company. A public offering of stock through an Initial Public Offering ("IPO") is the most visible exit and often the most remunerative. The second and more common exit is a sale or merger of the company, which may well mean that the entrepreneur has to be willing to give up his or her ownership and involvement in the company. A third way to pay off investors is to "redeem" the stock: i.e., buy it back. The money to buy the stock back can come from other investors, from a bank or other lender, or perhaps even from profits.

A business typically seeks venture capital when it is at a stage that requires a significant change in the way it operates to achieve the growth goals of its managers. Whether the change is bringing a new product to market, a substantial ramp-up in sales activities or the acquisition of new machinery and equipment, the choice of pursuing venture capital brings with it some important decisions for the entrepreneur. To help make those decisions, the next chapter outlines how venture investors work, what they are looking for and what they expect in return.

Is:	Is: Not:
A source of capital of high risk businesses	Right for "lifestyle" businesses or those without strong potential for growth
A source of "patient" capital	Money without strings or cost
An investment in the business	Money to repay nonbusiness-related debts and expenses
Money to drive business growth and development	An inexhaustible supply of money that will continue indefinitely
A validation of the business by outsiders	Free from restrictions and conditions imposed by the investors
A way to get access to the investors' contacts and resources	A loan that you can prepay at a low cost if things go well
A source of strategic planning, management and recruiting assistance	An end in itself; rather it is just the beginning of the relationship
A way to get help raising funds in the future	A guarantee that the free market will reward the business and investors
Money that does not have to be paid back by the entrepreneur if the business fails	Available unless the investors can see a way to liquidate their investment in 5-7 years.
Investment looking for a "liquidity event" so investors can cash out	Right for entrepreneurs who want to keep ownership and control indefinitely

Fig. 4.4. *What venture capital?*

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4.8 HOW VENTURE CAPITAL INVESTORS WORKS?

In order to understand how to approach venture capital investors successfully, it is important for entrepreneurs to understand how they work, what they are looking for, and what is important to them. While there are different types of venture capital investors with different goals, they all share a desire for a good return on their investment.

Success in raising money depends first and foremost on how well the entrepreneur makes the case that the business will be successful and produce an attractive return on investment. As disused earlier, there are four main categories of venture capital investors: venture capital firms, angel investors, corporate venture capital investors, and governmental investors. This Chapter will focus first on venture capital firms, which make up the traditional venture capital industry, outlining the general principles and business considerations that guide their investment strategies. It will then outline the other three categories of investors and how their goals and approaches may differ.

4.9 VENTURE CAPITAL FIRMS

Venture capital firms are entities, usually limited partnerships or limited liability companies, that raise funds from high net worth individuals and institutional investors to invest in a portfolio of business ventures with an expectation of a high return on investment. They are managed by experienced venture investors who have the credentials to entice sophisticated institutional and high net worth investors to place large amounts of money under their management. Of the four main categories of venture investors, venture capital firms are the most focused on generating the highest possible return on investment, because that is what their investors are paying them to do.

There are many different types of venture capital firms with different styles, investment targets, and return expectations. Some focus on early stage companies; others target later stage businesses with proven track records. Some seek a balanced portfolio with some early and some later stage investments. Still others specialize in specific industries, such as information technology or energy. Many focus on a limited geographic area, although some larger funds may invest nationally or internationally. And some, like Coastal Ventures and CEI Community Ventures, Inc. in Portland, invest with social goals as well as expectations of return on investment.

Fig. 4.5 shows a breakdown of generic types of venture capital firms and their average returns through the third quarter of 2002. The venture capital fund types in Fig. 4.5 are listed in declining order of the amount of risk they

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are typically willing to take. Seed and early stage funds take the most risk, investing in businesses that have not proven themselves in the market. Over time, seed and early stage funds have achieved the highest average annual rate of return. Balanced funds invest in a range from seed to later stage companies to spread risk. Later stage funds target companies that have proven their business plan in the marketplace and are striving for continued expansion. Buyout funds focus on mature companies that are recapitalizing or restructuring, usually leveraging equity investment with bank debt. And mezzanine funds tend to target proven performers that are close to a public stock offering or sale to a larger industry player. Their risk of having one of their investments fail is much lower than for seed and early stage funds, but their return potential is also lower on the investments that are successful.

Fund Type	*1 Year*	*5 Year*	*10 Year*	*20 Years*
Seed/Early Stage	–28.6%	44.1%	34.2%	20.7%
Balanced	–19.2%	22%	22.1%	14.7%
Later Stage	–16.4%	13.3%	23.7%	16.1%
Buyout	–8.2%	1.4%	8.8%	12.4%
Mezzanine	–1.6%	7.7%	10.9%	11%
Average of All Funds	–12.3%	8.3%	15.1%	14.5%

Fig. 4.5. *Average annualized rates of return on venture capital funds by type of fund.*

It is important for entrepreneurs to understand that in order to raise capital from venture capital firms, they will have to offer a reasonable prospect of paying much higher returns to the investors than these portfolio averages. In fact, seed and early stage venture firms target returns of 50% or more per year on each investment. The reasons for this are grounded in three realities of venture capital firm economics:

- The first reality of venture capital firm economics is that the returns shown in Fig. 4.5 reflect the entire portfolios of the venture capital funds, both the winners and the write-offs. Obviously, no one can predict which investments will be successful. The managers naturally hope and expect that each of their investments will succeed or they would not invest. But given the inevitability that some investments will fail and some will ultimately pay disappointing returns, all venture firms try to structure their investments so that the returns on successful investments are far higher than the averages. That way, the successful investments more than makeup for the losers.
- The second reality of venture firm economics is that the expenses of running each fund are deducted from the fund, and the fund averages shown in

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Fig. 4.5 are returns after all payments due to the managers. The managers have to target higher returns on each investment to be able to both get paid for their investment acumen and to beat the industry averages in Fig. 4.5. The typical arrangement between the managers and the investors in a venture capital fund is that the managers get 2.5% of funds under management each year (the "management fee") for the administrative expenses of operating the fund. In addition, as a reward and incentive to the managers, they are entitled to a "carried interest", which is a share of the profits of about 20%.

- The third reality of venture firm economics is that they strive to exceed the industry averages so that they can show future investors a track record that will encourage those investors to invest in the venture firm's next fund. It is harder for venture firms to raise money if their historical returns have been at, or below, industry averages. Investors in venture funds want to see above average, preferably "top quartile" returns: that is, returns that are better than three quarters of all comparable venture capital firms. And, of course, all venture firms want to perform significantly better than publicly traded stocks, since investors will not accept the risks of illiquid, private securities if they do not expect substantially higher returns.

There are two common ways of quantifying returns to investors. The more accurate way is to view the returns as an annualized rate of return over the period between investment and final return. This is referred to as the "Internal Rate of Return", or "IRR", and is expressed as a percentage as in Fig. 4.5. The other view is a simple cash-on-cash return: how much was the ultimate return compared to the amount invested, expressed as a percentage or a multiple.

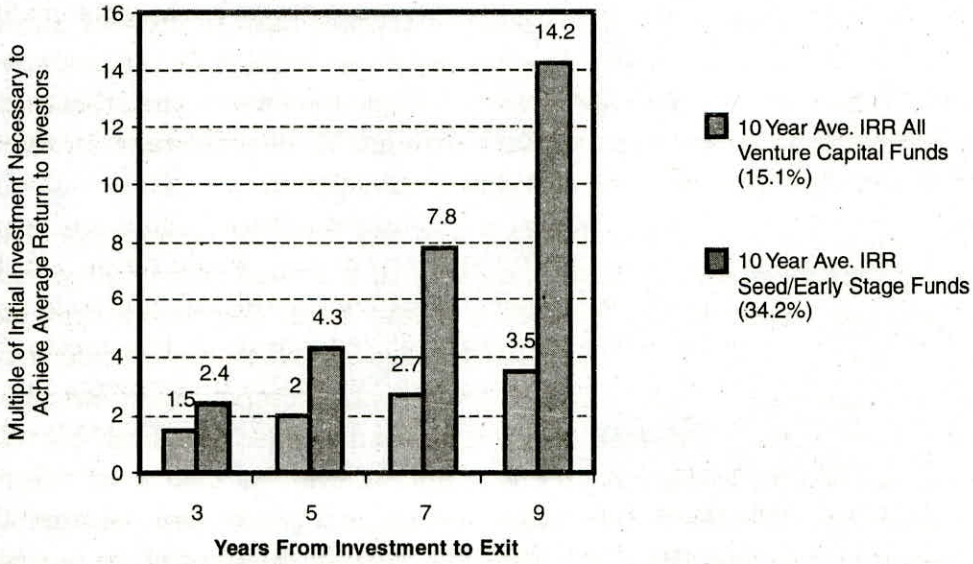

Fig. 4.6. *Multiple of initial investment needed to produce industry average return.*

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For example, if a fund invests $1,000,000 and receives back $5,000,000, their cash-on-cash return is 500% or "5x". Fig. 4.6 shows the relationship between the Internal Rate of Return calculation and the cash-on-cash return. For the venture capital investor, it answers the question "What multiple of my investment do I need to get back so that I am at least achieving an average return on my investment?"

The bottom axis shows the number of years between the original investment and the return of the investment to the fund, ranging from three to nine years. The bars show the multiple of the original investment needed to achieve just an average net return to the fund as compared to the 10-year averages shown in Fig. 4.6 for all venture capital funds, and for just seed and early stage funds.

For example, if a venture capital fund invests $1,000,000 in a business and the business is sold after seven years, the fund needs to recoup $2,700,000, or 2.7 times its investment on a cash-on-cash return basis, just to hit the 15.1% industry average Internal Rate of Return for all venture capital funds over the last 10 years, including the relatively low risk buyout and mezzanine funds. If that fund were instead a seed and early stage investment fund, its return would need to be $7,800,000, or 7.8 times its investment, to hit the 34.2% average Internal Rate of Return for seed and early stage funds. Naturally, most fund managers hope to get substantially higher returns to balance their portfolios and address the three venture firm economic realities discussed above.

This table also illustrates the importance of time in the venture capital equation. The longer the time between investment and return, the greater the return needs to be to provide the targeted annualized return on investment.

That is why venture capital firms push companies hard to grow as quickly as possible to the point where the company can be sold for an attractive return. So how do venture capital firms select investments to produce the high returns they are looking for? Each firm has its own strategy. However, the following investment principles guide most firms:

1. Be highly selective. The reality (a harsh one from the perspective of the entrepreneur) is that venture firms may look at and reject 100 or more investment opportunities for each one they fund. Sometimes they pass over great investment opportunities that are outside that particular firm's area of interest or specialty, or that are potential competitors of companies they have already invested in, or that would cause too much portfolio exposure to a particular industry, or simply because the deal is not referred to them by a trusted source. Many are quickly passed over because the Executive Summary does not convey the exciting potential of the business

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in a compelling way. Others do not meet the firm's exacting selection criteria. Most successful venture firms have a "deal flow pipeline" that brings in hundreds of qualified business plans each year. The managers can afford to be extremely selective about where to invest their time and money.

2. Seek companies with innovative products and "unfair" advantages in large, ripe markets. In order to grow at the rate necessary to produce venture capital-type returns, companies generally need to have unique or innovative technologies or services that put them well ahead of the competition, or that can make significant changes in their industries. This generally requires both a technical or product advantage, and a market that is ready to reward that advantage: that is, the customers are anxious for the product. Also, the market has to be big enough to offer the necessary growth potential and attractive exit opportunities.
3. Back outstanding management teams. Many venture investors believe that a strong management team will be successful even if the product is mediocre, while a poor management team will not get the job done no matter how good the product is. Some venture firms will only back teams that have shown the ability to manage a business successfully in the same or a similar industry. Other venture investors will help to assemble the right management team around the right product or idea. In either case, venture investors want to back managers who are capable, determined, and persistent, but who are willing to step aside if and when necessary for the good of the company and its investors.
4. Invest in companies with a clear and realistic exit strategy. Venture capital firms want to be close and effective partners with their portfolio companies, but only for as short a time as necessary to prepare the company for a profitable exit opportunity. Making an investment is only the beginning for a venture investor: getting the investment back with a maximized return is the end game. That means investors will look for companies that have the potential for a liquidation event such as the sale of the company or issuance of stock to the public through an Initial Public Offering (IPO) within a few years. In some cases, it may be possible for the company to buy the stock back from the investors, usually by borrowing the capital or finding new equity investors. Without an exit, an investment becomes one of the "walking dead" in a venture firm portfolio: too good to shut down, but not good enough to attract a buyer.
5. Add value to the development of the business and play a significant role in the ongoing management of the company. Particularly for early stage venture firms, the ideal investment is one where the venture firm has the experience, contacts, and strategic relationships to add significant value to the venture beyond the money invested. Generally, investors like to be

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actively involved by taking a seat on the Board of Directors and talking to the management team on a regular basis. Entrepreneurs should view venture firms not just as sources of capital, but also as invaluable resources for day-to-day management assistance, strategic planning, assistance in hiring the right management team, contacts with critical suppliers and customers, and help in raising additional capital.

6. Make sure that companies have access to enough cash to get to cash flow breakeven. The harsh investment climate of recent years has reminded venture investors of this rule. Many companies have foundered because they were unable to raise more money when their venture capital ran out and the existing venture investors were not willing to continue to fund ongoing losses. Investors pay close attention to the "burn rate", which is the amount by which spending is outpacing revenues each month. When the money runs out, the venture investor either has to put more in, hope the company can raise more, or write off the investment. There is no longer an inexhaustible supply of capital to support struggling companies and bail out prior investors, as there seemed to be during the venture industry "feeding frenzy" that ended in mid-2001.
7. Build a diverse investment portfolio. Particularly for seed and early stage investments, seasoned venture investors know that it is very difficult to predict which investments will succeed. When this risk is spread over a portfolio of 10 to 20 investments or more, the overall level of risk to the investors is greatly reduced. In a typical early stage portfolio, of every ten investments, perhaps four will be complete losses and three will become "walking dead": viable but not easy to liquidate. The lion's share of the returns to investors will come from the other three investments, which are the portfolio winners. Many funds also seek to diversify their portfolio so it is not too heavily weighted toward one industry or technology, where the entire portfolio could be dragged down by a single mistake.

Once a venture firm has identified a company that seems promising, it begins what is usually an exhaustive review and analysis process referred to as "due diligence". This review begins with extensive discussions with the members of the management team to assess their understanding of the product and the market, to test the business plan they have assembled, and to evaluate their ability to carry it out.

The prospective investors will then draw upon their own experience and contacts to make independent inquiries about the product or service and the market the company is focusing on. They will perform background checks on the management and talk to customers, suppliers, and competitors. They may employ experts on the technology, the production and distribution capabilities of the company, and the size and growth potential in the market to evaluate the investment proposal and to assess the possibilities for an

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exit. They will review the legal documents that created the business and that outline the ownership and control process, as well as employment contracts, stock option agreements, and personnel policies. They will closely investigate the company's claims of protection of intellectual property, such as patents, copyrights, trademarks, and determine whether the company owns or has the rights to the assets necessary to its operations.

Successful investors strive to know the business almost as well as the founder or chief executive officer. This intensive due diligence process allows the potential investors to make an informed judgment about whether the risk of the venture is outweighed by the potential for return on investment. The process involves a significant investment of time and money by the venture firm.

At the point in the due diligence process where the venture firm determines that it is seriously interested in making an investment, common practice is to issue a "term sheet" outlining the terms and conditions on which it is willing to make an investment. Once an investment is made, venture firms tend to be active investors, closely following the progress of the company and looking for ways to help management achieve its objectives. They are likely to ask for a seat on the Board of Directors, and certain to insist on regular financial reporting. Initially, their efforts are focused on helping the business grow. This can include everything from help in filling key management positions to introductions to potential customers, suppliers, and sources of follow-on capital. As the business prospers, venture firms begin to encourage the company to find an exit opportunity that the investor can convert its investment into cash. In this phase, venture investors can be helpful in attracting potential acquirers or developing other exit strategies. Many of the legal terms and conditions imposed by venture investors when they make an investment are designed to push the company toward a profitable exit event.

4.10 ANGEL INVESTORS

Angel investors are high net worth individuals who invest in as few as one, or as many as a dozen or so businesses, usually located near their home. They invest with an expectation of an attractive return, using many of the same criteria for weighing investment risk and return potential that a venture firm would use. Angels are attractive sources of capital for businesses for several reasons. First, they tend to be somewhat more accommodating to entrepreneurs than venture capital firms because they are investing their own money and have greater flexibility in making investment decisions. Second, they are willing to invest smaller amounts of money than venture

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firms and may be interested in investment prospects that are too small to interest venture capital firms.

Third, many angels have valuable experience and contacts from running their own businesses that can be useful to entrepreneurs, and they may have more time to invest than a venture firm does. Finally, angel investors may be interested in making an investment for reasons other than purely financial ones, such as a desire to share their experience with a local business, help out friends, or strengthen their community.

The nature of angel investors makes them particularly appropriate for early stage companies, helping bridge the financing gap until a company is ready to approach venture capital firms. In many cases, this role in bridging the financing gap is reflected in the way the angel investment is structured. For example, rather than developing an elaborate term sheet and arguing about valuation, an angel may invest through a "bridge note" that is designed to convert to equity on the same or similar terms and valuation as the next financing round. In effect, the angel leaves the structuring and valuation decisions to the venture firms who arrive later. If there is never another financing round, the investor hopes to get his or her money back through payments on the note, or the note may convert to stock.

The greatest drawback to angel capital is the difficulty in finding the right angel. Most angel investors do not advertise their investment interest, leaving it up to the entrepreneur to find them. The best way to find an angel investor is through the entrepreneur's existing network of friends, relatives and business contacts. Other options include angel networks like the CommonAngels in Boston or forums like the Maine Investment Exchange or CapitalVenue that bring entrepreneurs and angels together.

4.11 CORPORATE VENTURE INVESTORS

Corporate venture investors are companies that have their own business operations but that also make venture capital investments in smaller businesses. Like venture capital firms, corporate venture investors invest with the goal of an attractive return, using many of the same investment parameters.

The primary difference between a corporate venture investor and a venture capital firm is that corporate investors usually invest in businesses that offer a strategic benefit to the investor's business or that might be potential acquisition candidates in the future. Strategic benefits might include access to cutting-edge technology, insight into new business opportunities, or the ability to provide input into the development of an attractive product or service that the corporate investor needs.

Finding corporate investors is usually a matter of determining which companies might have a strategic reason to be supportive of the entrepreneur's business. To date, corporate venture capital activity has been limited in Maine.

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4.12 GOVERNMENTAL FUNDING

State and federal governments play a significant role in providing financial assistance to growing businesses, often on better terms than can be obtained from private investors. Financial assistance programs target job creation, rural development, research, and other public benefits.

In Maine, the Small Enterprise Growth Fund is a state-funded venture capital fund that currently can invest up to $500,000 in eligible Maine-based businesses. With statutory authority for the Fund vested in an 11-member, Governor-appointed Small Enterprise Growth Board, the Small Enterprise Growth Fund considers investments based on substantially the same criteria as a private venture capital fund. However, investment decisions are also based in part on public benefit criteria, including job creation.

Maine also provides capital for early stage technology-based ventures through the Maine Technology Institute, which provides grants or repayable investments for research and development leading to commercialization. Grants of up to $500,000 are awarded on a competitive basis, with applications reviewed by peer review panels.

The primary applicable program of the Federal Government is the Small Business Innovation Research (SBIR) Program. Administered by the U.S. Small Business Administration (SBA), the SBIR program is a grant program designed to support research and development activities by small businesses. Each year, ten federal agencies accept proposals for research and development in designated fields. Funding is competitive and is based on whether the application meets the qualifications of the agency requests for proposals, technical merit, the degree of innovation involved, and the potential for commercialization. SBIR grants are up to $100,000 for an initial six month Phase 1 project to investigate feasibility, and up to $750,000 in Phase 2 for expansion of the work done in a successful initial project. The SBA also administers the Small Business Investment Company (SBIC) Program, which provides investment capital to licensed venture capital companies that meet SBA criteria and observe SBA rules and regulations.

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4.13 HOW TO APPROACH VENTURE INVESTORS?

The best way to be successful in approaching venture investors is to offer them a well-constructed investment opportunity that meets their goals and objectives. The easier it is for the investor to see how attractive the opportunity is, the more likely he or she is to invest. The first step is to develop an executive summary describing the business opportunity in one to two pages, backed up by a business plan that outlines the business, the need for financing, and the opportunity for investors. While there are legendary deals cut over drinks and outlined on a cocktail napkin, the vast majority of investment decisions are made in a more deliberative fashion.

The executive summary is very important because it is often the key to getting an investor to read the business plan. It is a brief summary of the business plan, drafted in such a way that it communicates the excitement of the investment opportunity to the investor and whets his or her appetite to read the business plan. In verbal form, it is often called an "elevator pitch", which is an explanation that is both compelling and brief enough to be delivered in the time it takes an elevator to get from one floor to another. The business plan should be clear enough that the investor understands it and believes it. The plan should be designed to convey to a prospective investor a fairly complete description of the business and the investment opportunity. It should convince the reader that the author of the business plan has thought through the need for the capital, how it will be used, and what the impact on the business will be. A sloppy, incomplete, or superficial business plan gives a bad impression of the investment opportunity and the entrepreneur.

There are many business plan guides and tools available on the Internet and in the business sections of larger bookstores. While there is no required form, the business plan presented to a venture capitalist should cover certain basic points:

- The mission of the business and the objectives of the management team;
- A description of the product or service, its history, and an explanation of what problem it solves or what is unique or exciting about it;
- Objectives of any ongoing research and development activities;
- The ownership structure and capitalization;
- The amount of investment needed and what it will be used for;
- A description of the market and the competition, and where the company fits into the market;
- Whether the product or service has any proprietary advantage or other protection from competition;

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- A description of the industry, its growth trends, prospects, and its major challenges;
- The operations plan with an explanation of challenges, solutions, and strategic relationships;
- The marketing and sales strategy, with the names and size of principal customers;
- The organizational chart, with track records, compensation packages, and resumes of key management and board members, and hiring plans for unfilled positions;
- The historical financial data, along with financial objectives and projections, with assumptions, showing cash flow needs of the business and how they will be met; and
- A discussion of exit opportunities and strategies.

The business plan should be clear in conveying the excitement about the opportunity, but should also be frank in assessing the major challenges and risks. Failing to disclose and address major problems will only call into question the rest of the business plan and the integrity of the author.

Once the executive summary and business plan are put together, the challenge is getting them in front of investors. For privacy reasons, most angel investors do not want to be deluged with business plans from entrepreneurs seeking capital. Entrepreneurs usually find them through a referral from a mutual acquaintance. In some areas, there are angels who band together to review and discuss investment opportunities. These groups, like the Maine Investment Exchange ("MIX") based in Portland or the CommonAngels based in Boston, offer entrepreneurs a relatively quick and easy way to gain the attention of potential angel investors.

Venture firms are relatively easy to find. Venture capital firms in other areas can be easily located through Internet searches. It pays to do some research on venture firms before sending them an executive summary and business plan. Most firms have Web sites that outline the types of investments they are looking for, including geographic location, size, industry, and stage of development. There is no point in sending information to firms that are looking for something different. Most venture firm Web sites also include a list of portfolio companies. Entrepreneurs should prioritize firms that have invested in similar types of businesses, indicating that the firm has an interest in the industry sector and perhaps also some beneficial expertise. However, applicants should be leery of firms that have already invested in direct competitors. Venture firms are unlikely to invest in firms that are in direct competition with a prior investment and do not want to be in the position of having access to confidential information from an applicant that might be of use to that portfolio company.

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The entrepreneur should make every effort to set up a meeting with prospective venture firm investors to explain the opportunity and the business plan in person. This is not always easy, since venture firms cannot invest the time to meet with everyone who submits a business plan. Because of the fact that most venture firms see hundreds of investment opportunities each year, companies seeking capital should try to differentiate themselves to get attention. The best way to get attention and a meeting is to get an introduction to the venture firm from someone that the firm respects, such as a lawyer, an accountant, a scientist, a customer, a company in their investment portfolio, an investor in the fund, or an investor in the company. An introduction combined with a positive recommendation will often get an applicant priority attention. Alternatively, the entrepreneur should try to find a way to meet someone from the venture firm at a venture capital conference or a function designed to introduce investors to prospects, such as the periodic events sponsored by the Maine Investment Exchange or CapitalVenue. If the only available approach is to deliver an executive summary and business plan to the venture firm, it should be followed up with a telephone call and a request for a meeting.

In approaching venture firms, entrepreneurs should remember that these firms typically turn down 99 out of 100 applicants. Because venture firms target so few investments for each portfolio, the fact that they say "no" is not necessarily an adverse reflection on the entrepreneur. Venture firms pass over many potentially worthy investments for reasons unrelated to the merits of the proposal. For example, they may be targeting different technologies or industries, they may already have enough exposure to similar businesses, or they may be between funds and not actively investing.

If the answer is "no," the entrepreneur should try to find out as much as the venture firm will offer about why it was not interested. This information can be valuable in approaching other venture firms. It also may reveal a misunderstanding about the business plan that can be corrected or an obstacle that can be overcome. Entrepreneurs should try to distinguish between a "no" that can be turned into a "yes" and a "no" that is final. If the "no" is final, the entrepreneur can still ask for suggestions of other investors that might be interested in the business. Entrepreneurs should take care not to burn any bridges, but to learn from each "no" and look for ways to improve the business plan.

If the venture firm or angel expresses further interest, the investor usually determines the next steps. In this stage, it is critical that the company be responsive to the questions and concerns of the investor. Even a signed term sheet does not mean that the cash is in hand; the investor can still balk at anything that comes up during the due diligence process.

When the investor makes an investment, the relationship is only beginning. It is important that the company keeps the investor well informed and avoids

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unhappy surprises. The investor can be a key to the success of the business by providing wise counsel, contacts to important strategic partners, and more money when needed. Most businesses, particularly early stage ones, will have to go back to their investors for more money at some point, so it is important to continue to treat investors as well or better after they invest as they were treated before the investment. And in the long run, an entrepreneur who makes money for an investor has an advocate and supporter for life.

4.14 ARE YOU READY FOR VENTURE CAPITAL? A SELF-ASSESSMENT

There is no magic formula for determining when or whether a business is going to get funding from venture capital investors. However, the following table will give you an idea of whether you might be well received by investors and where you need to focus your attention on improving your Business Plan. Simply give your business an honest assessment on each of the questions and circle the highest applicable score in the column on the right. When you are done, add your scores. The key at the end of the assessment will give you an idea of how prepared you are for venture capital.

PRODUCT OR SERVICE	SCORE
1. How badly does your customer need this product or service?	
A "must-have" that solves an important problem	3
A compelling and unique product or service	2
The product or service is an improvement over the competition	1
Customers might want it but do not necessarily need it	0
I don't know whether there are customers for it	–2
2. Is there any protection from competitors?	
Patent protection is in hand or in process	2
Copyright protection or hard-to-discover trade secret	1
By the time competitors wake up. I'll have the top name in the market	0
No barriers to competition or the product is already available in the market	–2
STAGE DEVELOPMENT	
3. At what stage is your product development?	
The product is available and has been proven in the marketplace	2
There is a working prototype and it is ready for production	1
The product is developed but needs more work before it can be sold	0
We will develop the product as soon as we get venture capital	–2

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4. How much progress have you made in developing key customers?	
We have strong customers who are advocates for our products	2
We have identified key customers and are making good sales progress	1
We need to further develop the product before generating sales	0
5. Is your venture a business or a project?	
The business is operating, has growing revenues and happy customers	2
Everything is in place to launch the business as soon as we get funded	1
I need funding to finish product development and testing	0
MARKET SIZE AND SHARE	
6. How big is the potential market for your proudct?	
More than $500,000,000	2
$75,000,000 to $500,000,000	1
Less than $75,000,000	0
7. How fast is the market growing	
Greater than 20% per year	2
10% to 20% per year	1
Less than 10%	0
8. How big a share of the market can you realistically get in 5 years?	
Greater than 15%	2
5% to 15%	1
Less than 5%	0
MANAGEMENT	
9. How experienced is the Chief Executive Officer?	
Has run similar companies that have had successful exists for invetors	4
Has built and run a similar company successfully	3
Has extensive experience in the industry and is well known	2
Knows the product well	1
A CEO will be recruited	0
I can learn on the job	–2
10. Is the founder ready to relinquish control if necessary to make the business achive its full potential?	
Yes, the business need to be run by the best possible management team	2
Theoretically yes, but I do not plan to let that happen	0
No, this is my business and I know best how to make it successful	–2

READINESS TO PURSUE VENTURE CAPITAL	
11. Do you have a business plan?	
Yes, it is well researched, very complete, and customers are anxious	2
Yes, although I am still filling in some details	1
Only a rough outline, but the product is great	0
This idea is so good it doesn't need a business plan	–3
12. Are you willing to allow investors to be involved in business decision?	
Yes, they will serve on the Board and play an influential role	2
I will put them on an Advisory Board	1
No, I really don't think they can help me right now	0
13. What percentage of the ownership in your company are you willing to give up?	
I will give up one-third or more for the right investors	2
I would rather not give up more than a quarter of my company	1
I will give up a small amount of ownership if I have to	0
RETURN POTENTIAL	
14. What return on investment can your investors expect?	
Ten times their investment or more	3
Six to nine times their investment	2
Four to five times their investment	1
Less than four times their investment	0
15. How long do you realistically think it will be before the investors can receive their return on investment?	
Five years or less	2
Five to seven years	1
More than seven years	0
16. How do you realistically expect the investors to get their return on investment?	
We will be an attractive IPO candidate or candidate for sale to the leaders in our industry	2
We will be acquired by a similar company in our industry	1
We will pay dividends and the company or I will buy their stock back	0
OTHER	
17. I plan to use the money raised to:	
Further develop the business	0
Pay my living expenses	–2
Pay off debt or other investors	–3
18. When this money is spent, I will:	
Be profitable and growing rapidly	2
Be at cash flow breakeven and growing, with profits in sight	1
Be at cash flow breakeven	0
Need to raise more money to keep going	–3
Grand Total:	

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4.15 HOW DID YOU SCORE?

- **Point total 30 to 38:** You have an interesting proposal that should garner the interest of venture investors.
- **Point total 23 to 29:** Your business has possibilities and might be of interest to angel investors, but probably needs more work before you will be able to raise significant venture capital.
- **Point total 16 to 22:** You may be on to something here, but you probably have a way to go to attract investors.
- **Point total 10 to 15:** A long shot. Reread this Primer and go back to the drawing board.
- **Point total below 10:** You should probably not expect to raise venture capital for this venture.

4.16 INVESTMENT STRUCTURE AND VALUATION

Congratulations! You have found a venture investor who wants to provide you with the capital you need to move your business to the next level. You have received a term sheet from the investor that outlines the amount of money that will be invested in your company, the percentage of ownership or rights to ownership the investor is expecting, and the significant terms and conditions of the financing. You are ready to agree to it and anxious to get a check.

But before you sign the term sheet, you need to make sure you understand what all the fine print means. Ideally, you should have your attorney review any term sheet, as well any documents that are necessary for the closing of the investment. If you have not already started working with an attorney, this is the time to retain one, or you may regret it and pay a price later. You should select someone who is familiar with venture capital financing, understands accepted practices in the industry, and which provisions in the term sheet and closing documents can and should be negotiated. An inexperience attorney can do your relationship with the investors more harm than good and cost you needless time and money.

The first thing to be aware of is that usually the term sheet will specifically say that it is nonbinding and an expression of intent, not a firm commitment. Because the term sheet is nonbinding, you should not act on the assumption you have money in the bank until the deal is closed and you do, in fact, have money in the bank. Investors can and do change their minds and decide not to make investments for which they have issued term sheets, usually because they learn something while making further investigation that makes the

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investment less attractive, or possibly because they find out that something you told them is not true. To the extent any provisions are intended to be binding, they are specifically stated in the term sheet. Binding provisions might include an obligation to pay the investor's closing expenses and attorney's fees, even if the investment does not take place, or a requirement that the business not talk to other prospective investors for some designated period of time.

A major issue, and one that tends to be hotly debated between the company and the investor, is the valuation of the company. The valuation is important because it determines the percent of the ownership of the company that the investor is buying. The entrepreneur argues for a higher valuation so his or her percentage of ownership stays as high as possible. The investor argues for a lower valuation in order to maximize its return on investment.

The determination of what the valuation should be is more art than science, particularly for early stage companies that do not have a track record of revenues and earnings. Venture investors are primarily concerned with arriving at a valuation that can provide them with their targeted return on investment. Valuation requires an estimation of the company's potential for growth and its likelihood of achieving that growth. Further, prospective investors will make an assessment of how similar companies are being valued in the market today, and a prediction of how attractive the company will be in the marketplace after three to five years of successful operations. From the perspective of investors, the amount of time, effort and money previously invested in the company is not very relevant to its valuation, nor is the valuation that might have been placed on the company by earlier investors.

One common method of establishing a valuation is to project what the revenues or profits of the company will be in five years and multiply those revenues or profits by the projected ratio of price to revenues or price to earnings that might be applicable to companies in that industry at that time. The result, the valuation at the five-year mark, is then discounted back to the present using a discount rate equal to the hoped-for internal rate of return on the investment. To the investor, the resulting number represents the valuation today that will allow them to achieve their desired return on investment at some point in the future. Venture investors are naturally likely to take a more conservative view of future revenues and profits than you do for purposes of determining what your company's value is, to provide some cushion if things do not go as well as you expect. You should not take this as an adverse reflection on your credibility or honesty. Rather, it is a reflection of the investor's experience that businesses do not always progress according to projections.

Ideally, you would like to have several venture capital firms or investors competing to invest in your company. Then you can truly test what valuation

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the market will bear. The fewer term sheets you have, and the more you need the money, the less negotiating leverage you will have. Also, the advice, experience and connections an investor can bring to the company may be of great value. In the long run, how well the company performs and the price it is ultimately worth in the future is more important than getting the highest possible valuation today. If the venture investor brings needed expertise or connections to potential customers, strategic partners and future sources of capital, that contribution can be more valuable than the investment they are making.

Equity investors talk about valuations either "pre-money" or "post-money", and it is important to understand the difference. "Pre-money" valuation is what the investor is valuing your company at before he or she makes an investment, while "post-money" is the "pre-money" valuation plus the amount of the new investment in the company. For example, if an investor invests $1,000,000 at a pre-money valuation of $3,000,000, the post-money valuation on the date the investment occurs is $4,000,000 and the investor owns, or has the right to own, 25% of the company. If, however, the investor puts in $1,000,000 at a post-money valuation of $3,000,000, the investor will own 33% of the company.

You should be prepared to generate a table outlining the capitalization of your company. Commonly referred to as a "cap table", this is an important tool for both you and your investors to understand the ownership of the company today and on the day after the investment takes place. The new investment results in "dilution" of the ownership of any existing shareholders. For example, if you are the only owner today, you own 100% of the company. If an investor puts in $1,000,000 at a $3,000,000 pre-money valuation, you will own 75% of a company now worth $4,000,000. *Note that the value of your ownership interest has not changed even though you no longer own 100%.* Investors will want to know what your plans are for issuing stock options, and may place limitations on them because of their potential impact on dilution. Stock options are a right to purchase stock in the company at a designated price at the election of the holder of the option. Options are generally used to provide an incentive to employees or other key people to support the growth of the company. The difference between the "strike price" (the price the option can be exercised at) and the value of the stock on the day the option is exercised can provide a significant financial benefit to the option holder when the stock becomes marketable. Stock options having a strike price less than the value of the stock are referred to as "in the money". On the other hand, when the stock price is less than the option strike price, the options are "under water". Stock options, if any are issued or reserved for issue, need to be factored into the cap table on a fully diluted basis: i.e., assuming they are exercised, so everyone can understand what their fully

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diluted ownership position is. The same is true of any warrants issued or to be issued by the company. Like stock options, warrants are rights to purchase stock in the future at a designated "strike price", and exercise of those warrants dilutes the ownership of all existing shareholders. Commonly granted to investors or entities that have loaned money to the company, warrants differ from options in that they are, or may, be separately tradable, whereas options are usually only for the benefit of the initial recipient. Some investors, particularly in later stage companies, may structure their investment as a loan with an "equity kicker" in the form of warrants. Those investors get their return on investment through payments of principal and interest, plus they share in the increased value of the company through the warrants to buy stock in the future should it increase above their strike price.

An important consideration is the extent to which the investor expects to have control of the company. While the investor will in most cases have voting stock equal to its percentage ownership, it is also likely to require one or more positions on the company's board of directors. Since the board of directors control key business decisions, not the least of which is the employment and compensation of key personnel, the composition of the board is important both to the entrepreneurs and the investors. While it is typical for investors to have less than a majority on the board, it is not unusual to have provisions that give the investors the right to appoint additional board members under certain conditions, such as failure to meet agreed benchmarks. Also common are provisions that require supermajorities (two-thirds or three-quarters of the board members, for example) for certain major decisions, such as taking on additional investors or selling the company or its assets.

The term sheet will also outline what form the investor's equity interest will take and what rights will be required. From the entrepreneur's point of view, you would like it if the investor purchases common stock, the same security you probably own. Common stock is the basic unit of equity ownership. Investors, however, usually expect to be granted "preferred stock", giving them some priorities and other advantages over common stockholders, and reflecting the fact that they are paying cash for their stock while the majority owners may have gotten their shares in exchange for "sweat equity". Later rounds of investors may additionally expect preference over prior preferred investors. The term sheet outlines what the investor expects its preferred stock will look like.

As the name implies, preferred stock has specified preferences over common stock, the most typical being outlined below:

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Dividend Preference

Some preferred stock investments will require that a dividend of some specified percent be accrued on the preferred stock and paid before any dividend can be paid to holders of common stock. Others may not specifically provide for a dividend payment, but almost certainly will require that no dividend be paid to the common holders unless the preferred holders are also paid. In cases where there is more than one "series" of preferred stock, the later investors may demand dividend preference over holders of earlier series.

Liquidation Preference

What if your $4,000,000 post-money company has to be liquidated in a year for $1,000,000? You as the holder of common stock would like to split the proceeds on a pro rata basis with all of your investors, but holders of preferred stock are going to insist that they get paid first. In this example, the preferred holders would get their money back and you and the other common holders would get nothing. In fact, preferred holders will probably not be happy just to get their money back first in the event of a distress sale of the company. Most will expect all of their accrued but unpaid dividends to be paid as well. It has also become increasingly common for investors to ask for dividends plus a multiple of two or three times their investment. That increases the chances that the investors will achieve a decent return if the company is sold at a distress price, but it also increases the likelihood that the holders of common stock will receive nothing.

Conversion Rights

Preferred stock typically comes with the right to convert to common stock at the option of the holder. For example, if the company is successful and able to go to the public stock markets with an Initial Public Offering ("IPO"), preferred holders will usually convert to common stock right before the IPO. The common stock can then be sold at the price of publicly traded stock, although such sale is often subject to a restriction on sale for a period of time after the IPO. If the company is being sold to another company at a significantly higher price than the post-money valuation at the time the preferred stock was issued, the preferred holders will likely convert and be paid their pro rata share of the profitable sale.

Participating Preferred Stock

Traditionally, preferred stock holders could hold their preferred stock and be paid their investment amount plus any accrued dividends, or they could convert to common stock and share in the bounty of an IPO or favorable sale. Since the bursting of the technology bubble and the decline in private equity

investment activity, however, it has become common for preferred holders to get the benefits of both. In the case of "participating preferred stock", the holders are entitled to have their investment repaid along with any accrued dividends and any multiple of their investment they may have negotiated, and then still retain the right to convert to common stock and "participate" along with all other common stockholders in the remaining proceeds of a favorable sale or IPO.

Redemption Rights

Investors usually have the right to require the company to "redeem" or repurchase the investors' shares at or after a designated period of time and at a specified price. While not often exercised, this right provides the investors with another potential exit opportunity. Investors would consider using a redemption provision in the case of a company that was doing well enough to be able to raise the capital to pay the redemption price, but not well enough to attract a buyer at a favorable price. It is also a tool to prod the managers of the company to look for a buyer when they might prefer not to.

Antidilution Protection

Antidilution provisions protect the investors' pro rata ownership of the company in the case of events such as stock splits or the issuance of dividends in the form of stock. In addition, antidilution provisions generally address what happens if the company sells additional stock to investors.

In its simplest form, an antidilution provision will require that if the number of common shares increases due to a stock split or stock dividend, then the number of shares into which the preferred stock can convert must increase accordingly. For example, if the company issues each holder of common stock a new share of stock for each share already owned, the number of shares of common stock doubles and the value of each share is cut in half. In that case, preferred holders want to be able to convert their stock into double the number of common shares to protect their percentage ownership of the company.

More complicated issues arise when the company wants to issue new shares of stock to new investors. The issuance of stock to new investors dilutes the ownership of each existing investor. For example, if you own 60% of the company you founded and you have sold 40% to Investor A, and later you want to sell 25% to Investor B, your percentage ownership and Investor A's percentage ownership (on an as-converted basis) would have to drop since the total ownership cannot exceed 100%. In this example, Investor A would now own 30% (40% of 75%) of the company, while you would own 45% (60% of 75%). Investor A can avoid this by exercising a "pre-emptive right" to

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purchase the stock offered to Investor B. Or, if Investor B is paying a price per share higher than Investor A paid, Investor A may be satisfied that even though its percentage ownership has declined, the value of its investment has actually risen. The problem arises when the stock offered to Investor B is at a lower price per share. In that case, Investor A's antidilution protection kicks in. If Investor A has a right to "full ratchet" antidilution protection, and assuming the price to Investor B is half the price per share paid by Investor A, Investor A is entitled to convert into twice as many shares. That right to additional shares comes at the expense of the common stockholders, who are diluted twice: once by the addition of Investor B and then by the increased number of shares that Investor A's investment can be converted into.

This result can be quite draconian if Investor B is only buying a small number of shares for a relatively small amount of money. From the founder's point of view, so-called "weighted average" antidilution protection is much more tolerable. Instead of recalculating Investor A's right to convert at the lower price paid by Investor B, a formula is used to prorate the adjustment based on how much stock is being sold to Investor B, a result that is more favorable to common shareholders than "full ratchet" antidilution.

Registration Rights

In the happy event that the company is successful and becomes attractive to the public equity markets, investors may have registration rights: that is, the right to require the company to register some percentage of the common stock of the company for offering to the public. This is not often exercised, but it is a tool investors can use to push the company toward an exit event.

While many of the terms and conditions outlined above are clearly designed to protect and benefit the investors, most sophisticated investors will not demand overly burdensome preferential provisions because they want the managers of the company to have the financial incentive to make the company as successful as possible. That usually requires an alignment of interest between the management team and the investors: everyone is in the same boat and all oars are pulling in the same direction. If the terms are so onerous that the entrepreneur and management team no longer have the incentive to see the business grow, the terms are self-defeating for the investor. The entrepreneur has every right to negotiate provisions he or she is comfortable with, and the more anxious the investor is to make the investment, the more flexible the terms will be. On the other hand, entrepreneurs need to be careful about sending a message to the prospective investor that their respective interests are not aligned. A rocky courtship does not bode well for a strong marriage.

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4.17 SUMMARY

- Although women entrepreneurs have become a significant economic force in the UK, and rates of activity are catching up with those of men, the literature on female entrepreneurship is still relatively underdeveloped.
- While a family business shares many of the problems that any business would, there are some unique aspects that are brought into sharp focus by the complexity of personal family relationships.
- The range of business investment opportunities that interest venture investors is quite broad and hard to precisely define.
- Venture capital firms are entities, usually limited partnerships or limited liability companies, that raise funds from high net worth individuals and institutional investors to invest in a portfolio of business ventures with an expectation of a high return on investment.
- Angel investors are high net worth individuals who invest in as few as one, or as many as a dozen or so businesses, usually located near their home.
- The nature of angel investors makes them particularly appropriate for early stage companies, helping bridge the financing gap until a company is ready to approach venture capital firms.
- Corporate venture investors are companies that have their own business operations but that also make venture capital investments in smaller businesses.
- The best way to be successful in approaching venture investors is to offer them a well-constructed investment opportunity that meets their goals and objectives.

4.18 REVIEW QUESTIONS

1. 'The key to success in entrepreneurship is motivation'. Discuss this proposition with reference to (*a*) entrepreneurs from ethnic minorities, (*b*) entrepreneurs that are female and (*c*) entrepreneurs under the age of 25.
2. Is it valid to claim that women are more consultative owner– managers than men?
3. What factors might account for the more positive attitudes to enterprise by younger people in the UK?
4. Analyse your attitudes towards risk and consider how this might influence your career preferences.

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5. If you were to consider setting up in business, what social and business networks would you need to develop, and why?
6. What do you understand by venture capital?
7. Explain the term: Venture Capital Firms.
8. Discuss the planning to attract the venture investor.
9. Visit any firm and calculate the possibilities of venture investment.
10. In a group, Discuss the infrastructure and valuation of venture capital.

4.19 FURTHER READINGS

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