

managing india's small industrial economy



The Catalytic Role of
Industrial Counsellors
and Policy Makers

V. Padmanand • V.G. Patel

SMALL INDUSTRIAL ECONOMY

MANAGING INDIA'S

Managing India's Small Industrial Economy

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Counsellors and Policy Makers

V. Padmanand • V.G. Patel



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We dedicate this volume to the engine of growth
that will take us to super-power status—the
never-say-die Indian entrepreneur

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List of Abbreviations

BTRA	: Bombay Textile Research Association
CFC	: Common facility centre
CIS	: Confederation of Independent States
DCSSI	: Development Commissioner—Small Scale Industries
DEPB	: Duty Entitlement Pass Book scheme
DFL	: Degree of financial leverage
DOL	: Degree of operating leverage
DST	: Department of Science and Technology
DTL	: Degree of total leverage
EBIT	: Earnings before Interest & Tax
EDI	: Entrepreneurship Development Institute
EOQ	: Economic Order Quantity
FDI	: Foreign Direct Investment
FICCI	: Federation of Indian Chambers of Commerce and Industry
IDBI	: Industrial Development Bank of India
IIFT	: Indian Institute of Foreign Trade
IMF	: International Monetary Fund
ITPO	: Indian Trade Promotion Organisation
LC	: Letter of Credit
MCGF	: Mutual Credit Guarantee Fund scheme
MICS	: Management Information and Control System

MIS	: Management Information Systems
NABARD	: National Bank for Agriculture and Rural Development
NEF	: National Equity Fund
NFS	: Non-factory Sector
NGO	: Non government organisation
NHDC	: National Handloom Development Corporation
NIFT	: National Institute of Fashion Technology
NMCP	: Netherland Management Co-operation Programme
NPA	: Non-Performing Asset
NSIC	: National Small Industries Corporation
PBIT	: Profit before Interest and Tax
PBT	: Profit before tax
PIL	: Public Interest Litigation
PPBDS	: Private and public business development service providers
ROE	: Return on Equity
SBI	: State Bank of India
SFC	: State Financial Corporation
SIDBI	: Small Industries Development Bank of India
SIPA	: South India Producers Association
SISIs	: Small Industries Service Institutes
SITRA	: South India Textile Research Association
SMEs	: Small and Medium Enterprises
SSI	: Small scale industry
TPA	: Tonnes per annum
TUF	: Technology upgradation fund
UNIDO	: United Nations Industrial Development Organisation
USAID	: United States Agency for International Development
VC	: Variable Cost
VDIS	: Voluntary Disclosure of Income Scheme
WCTL	: Working Capital Term Loan
WTO	: World Trade Organisation

Foreword

Indian industry is facing immense challenges in the era of globalisation. While some enterprises continue to perform well, others are in relatively poor shape. This circumstance is particularly applicable to enterprises in the small and medium enterprise (SME) sector. Academicians and policymakers have been working intensively to haul up the smaller sector through various initiatives such as cluster development. Nevertheless, they face constraints in terms of a dearth of industrial counsellors and consultants who can work on applying various theoretical as well as empirically-validated options to develop industry.

In this context, it gives me great pleasure to write the foreword for this volume which compiles the experience of the authors in developing Indian industry. The book is 'prescriptive' and very analytical in its approach. The need for synergies between an industrial counsellor and the policy maker is well established by means of very vivid case studies from different sectors across the country. The concepts relating to management upgradation, efficiency linkages between various service providers and industry, and the need for 'networking' amongst smaller enterprises themselves have universal applicability and cut across sectoral boundaries. An industrial counsellor needs to help in developing both enterprises as well as industrial

associations in a holistic and sustainable fashion. The book provides great insights into concepts such as scale of operations, optimisation, cost competitiveness and the concept of 'consortia'. The volume covers a wide ambit—right from management assessment and rehabilitation of an enterprise to policy imperatives for sustainable development. The dynamics of the environment in which the small-scale sector operates is such that policy will have to play a guiding, canalising and catalysing role as is evident from the success stories of the South East Asian economies.

I complement the authors for this very useful addition to the literature in the area of industrial development. I sincerely hope that this volume will encourage more work along these lines by experts focusing on applied solutions for Indian industry as well as other developing countries. I recommend this book to policy makers, implementers, counsellors, professionals assisting industry, students of management and economics as well as the dynamic existing and potential entrepreneurs of India.

9.1.2004

C.P. Thakur
Minister
Development on North-Eastern Region
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Government of India

Preface

Small is beautiful: renowned economist E.F. Schumacher popularised this famous, and now clichéd, aphorism. Joseph Schumpeter argued that entrepreneurs created technical and financial innovations in the face of competition and falling profits—and it was these spurts of activity that generated economic growth.

Innovation is one thing—but a grim battle for survival is quite another. Small-scale enterprises in India appear to endorse the truth of Schumpeter's theory by continuing to thrive in an industry that has either gone into the sunset phase or where the economies for large-scale manufacturing no longer exist. Most small enterprises are able to sustain operations in niche markets—where the market is either fragmented or where the focus is on low-volume customised products.

However, the cold wind of cost competition from overseas firms is forcing a quick re-assessment of the aphorism. The verdict: small is still beautiful—but only in the manufacturing phase! There is a whole range of associated activities—input procurement, sourcing of institutional funds, and marketing—where it doesn't pay any longer to be small. Small enterprises are quickly wisening up to the need to form hard networks—for instance, an alliance of firms operating within an industrial cluster to

co-ordinate input buying and product marketing—to share their production costs and enhance their bargaining strengths. Networks are also required to establish necessary support for common facility centres (CFCs) to harness technology that will boost productivity and product quality.

Small enterprises, however, lack managerial vision. Their top managers are constantly having to cope with the grim realities of the present and they neither have the time nor the talent to envision the future. This makes a compelling case for hiring industrial counsellors who can examine trends and draw up a roadmap for the future. The role of the industrial counsellor for small enterprises is, therefore, critical. A counsellor needs to crystallise the options available to enterprises to thwart the price warriors from abroad who threaten to swamp their markets.

However, this is just one area that calls for intervention by industrial counsellors. There are several others: counsellors need to ensure that the management in small industry is professionalised in all functional areas. Small enterprises have several advantages going for them: the need for limited resources, access to cheap labour and the artfulness to avoid paying statutory dues like excise duty. But these aren't enough to ensure the sustainability of profitable operations. A counsellor may, therefore, have to seek out new markets and product opportunities in order to reduce business risks and find ways to synergise the roles of different actors such as specialised private and public business development service providers, financial institutions, the government, research institutions and industry associations.

Competent and specialised counsellors also need to educate entrepreneurs of small enterprises about the virtues of cost and capital structuring of projects, costing and pricing of business, developing and maintaining utilitarian systems in business to facilitate efficient decision-making,

clean and transparent presentation of financial statements to funding institutions, preparation of business plans, efficient liquidity and working capital management, and inventory management. An industrial counsellor may play a catalytic role in those areas where he may find it difficult to make a contribution himself.

The biggest challenge for the counsellor is the revitalisation of the small enterprise. Once he has examined the entrepreneur-enterprise typologies, the counsellor needs to make a substantial intervention by crystallising options that enterprises can pick from to build networks in the areas of marketing, finance, purchase of inputs and common facility centres. The counsellor needs to have the expertise and a missionary zeal to revitalise small enterprises so that they can stand up to competition from nimble overseas firms. He also needs to reorient the thinking that goes into policy making in the light of his deep insights on intra- and inter-enterprise dynamics. While pro-active industry associations may serve as the vehicle to catalyse such intervention, policy makers will also have to understand the circumstances of Indian small business in order to play a facilitating role.

Many of the concepts propagated in this volume are also applicable to larger enterprises. The volume is not intended for 'greenhorns' in the arena of industrial counselling or fresh students of management, but rather students of advanced management, practitioners and policy makers. Although simple, the concepts require a certain level of maturity to imbibe!

The cases and plethora of analytical methodology and tools presented herein do not 'follow the book' in the conventional sense. They serve to merely highlight options and illustrate indicative, 'developed' (names and circumstances of enterprises and some other actors are disguised) and applied analysis and solutions in different 'sectoral' and enterprise contexts to facilitate comprehension. Detailed analysis, necessarily customised, and more

elaborate would obviously underpin the interventions by a counsellor or policy maker. Indian industry is in an era where small enterprises survive with (as they would believe) profit margins of 5 to 8 per cent. Margin levels have fallen several fold in the last few years. In fact, even the 5–8 per cent margin levels are on the basis of considering only return on current assets or money locked-up in 'rotation', and ignoring capital employed, that is, fixed investment! Something must be done and soon! *Small industry in India may yet remain a sustainable segment of the 'globalised village' of the morrow.*

**V. Padmanand
V.G. Patel**

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Chapter 1

Counsellors to Quell the Death Knell for Small Industry

Uncompetitive Despite Competitive Advantages

An overwhelming majority of enterprises in the Indian subcontinent are small. In sectors where the product life cycles have reached their final stages, or where labour costs form the most critical variable cost and in industries with relatively little scope to reap economies of scale in manufacturing, small scale enterprises may well survive and thrive. However, competition from developing countries and from the economies of the Far East and South East Asia bodes ill for relevant sectors in the Indian industrial firmament. Cotton textile units in Tirupur, knitwear units in Ludhiana, leather units in Kolkata and Chennai, seafood factories at Kochi and Kolkata, machine tools units in Bangalore, and units in the dyes and chemicals sector in Ahmedabad are facing severe competition

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arising from 'dumping' and exchange rate fluctuations since 1997. Capital account convertibility ignited the currency crisis in South East Asia around this period. The crisis and subsequent 'correction' in exchange rates made their products cost competitive internationally. India's small industry remains cost and price uncompetitive. There are significant lessons to be learnt from South East Asia and the Far East.

The options for survival lie in the ability of enterprises to imbibe professionalism in functional areas of production, finance, marketing and technology upgradation. Policy reorientation is equally important as, for instance, the removal of product category reservation for the small scale industry (SSI) sector in order to encourage scalar growth and phased removal of the subsidy and the 'dole' culture for existing SSIs. Rewards for performance and efficiency should be provided in terms of tax holidays with regard to corporate income tax rather than support through investment subsidies and protection through tariff barriers. The latter are unsustainable given the stipulation on fiscal deficits by the International Monetary Fund (IMF) and norms to 'globalise' under the aegis of the World Trade Organisation (WTO). Industrial counsellors and policy makers have a critical role to play in revitalising India's small industry. The scope is elaborated in the following sections.

Counselling on Networking and Product Diversification

Even in the predominantly small industry sectors where Indian enterprises could gain or reap competitive advantage, they are being beaten by international competition. Enterprises manufacturing standardised leather products such as leather garments and shoes are outpriced by competitors in South East Asia. Imported electronics

and engineering products including machine tools are sold in India at a fraction of the manufacturing costs of our small enterprises. An important lesson to be learnt is that 'small' may well remain 'beautiful' but only in the manufacturing phase. Marketing and raw material purchase require the muscle of scale.

It is essential to develop 'hard' networks of small enterprises or business consortia. The Chinese and many of the South East Asian economies import raw material and export 'old economy' products metalware, textiles, seafood and leather products—through large players who can match the financial and resource strengths of multinational corporations (MNCs) in the West. These players procure inputs at cheap 'world prices', offer better credit terms, slash prices and still survive in the short and medium term. They invest in brand development, and product design development in different textile and leather garment sectors. They also have access to 'large volume' markets such as the Americas. Small firms in India lack these advantages. Hence, manufacturing in sectors that have reached the maturity stage of their life cycle could well be the forte of small enterprises. The relative dearth of scale economies in manufacturing and labour cost advantages in some sectors ensures this. Moreover, large players will not pursue manufacturing operations in these sectors in such circumstance. Nevertheless, efficiency on the raw material and marketing fronts is invariably the forte of large players or, networks of small enterprises. Counselling intervention on this front is a requirement.

A small scale operation is fine and, in fact, ideal in the manufacturing phase in many sectors. Marketing and raw material operations may, however, require the muscle of scale. Economies of scale invariably exist on these two fronts. One way to resolve this paradox is to encourage small enterprises to operate jointly as 'networks' or consortia in some activities and functions.

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Many geographically agglomerated small enterprises (clusters) in the subcontinent have been facing a cash crisis due to raw material shortages, Public Interest Litigation (PIL) against emitted pollution such as that imposed on leather tanneries near Chennai and in large aquaculture units in the marine product sector in Kochi given sea water intrusion; or due to non-tariff barriers such as socio-eco labelling related barriers imposed by buyer markets abroad. Quality and concomitant investment requirements imposed on the marine product industry is an example of the latter. Identifying avenues for maintaining sustainable cash flows during crisis years in a particular industry is an essential prerequisite for survival. To what avail is an export-oriented seafood cold storage if premium lobster and shrimp, for instance, is not available for a few months? The enterprise needs counselling on technology to appropriately modify storage parameters in terms of temperature and humidity controls in order to deal in eggs and meat targeting the same export market.

In the last few years, currency crises and devaluation in South East Asian economies with capital account convertibility have made them even more cost competitive in certain sectors. An Indian enterprise cannot afford to remain idle in the face of such raw material or competitive market-related crises. Cash is the oxygen for an enterprise and, unless alternative sources for cash circulation is available, erosion of working capital and bankruptcy are inevitable. Many enterprises in the seafood, textile and the leather product sectors serve as perfect reference cases. The option for market-led diversification such as through enhanced focus on Scandinavian, Confederation of Independent States (CIS) or South American markets for the leather goods industry merit attention. Enterprises with scope for product or market-led diversification have greater resilience to random or systemic business risk. Counselling support is required for enterprises to explore relevant options.

Identifying Niche Options

Identifying the scope for the manufacture of customised products is one means by which smaller players in different sectors can sustainably compete against the large trading houses and consortia abroad. Offering small-volume customised leather goods such as wallets and gloves to speciality stores rather than attempting to tap the large volume standardised 'chain store' channel for marketing leather garments and shoes has helped several small players in the Indian leather product sector survive cost competition from South East Asia. The scope for customisation of rubber gloves may be low but that for leather goods is high. The Malaysians and Far Easterners would find it more difficult to beat our enterprises in the latter area regardless of advantage in their cost of raw material.

'Globalised' Orientation and Facilitating Policies

Active export market focus is strongly associated with the sustainable growth of an enterprise while focus on domestic markets invariably leaves an enterprise static. The export-oriented cotton hosiery enterprises in Tirupur and the brassware enterprises in Moradabad display good performance over the years. Domestic market-oriented diesel engine enterprises in Phagwara and Batala have not performed too well in the liberalising Indian economy. Consider the 'industrial' brass parts manufacturers in Jamnagar, for instance. They remain largely domestic market focussed. Hence, they cannot utilise the Advance Licence route to procure duty-free raw material at cheap international prices. The difference in local and 'world prices' may be between 10–50 per cent in inputs like

cotton, brass and polymers. They, therefore, face intense cost competition even in their markets in India. Counseling for international marketing orientation is critical.

Policies serve as a catalyst to render greater dynamism in small industry sectors. In the leather product sector, export-oriented policy measures were evolved such as a ban on the export of raw and pickled hides and skins in the 1970s and of semi-finished leather in 1990, and provision of incentives for export of value-added products. India turned from a hides-and-skins exporter to a globally competitive finished product exporter. A counsellor needs to work on evolving optimal policy modes for small enterprises even while pursuing interventions at the enterprise level. Counsellors need to orient themselves towards working more closely with policy makers, directly, or through industrial associations. Industrial associations are essentially 'soft' networks of enterprises. They are networks oriented largely towards advocacy to authorities and not a 'hard' network of enterprises (consortia) for commercial operation and gain.

It is not uncommon to find several enterprises claiming the same stocks within a godown or cold storage to constitute their own inventory of raw material or finished goods in the agro-processing sector, for instance. The plethora of bankers facilitates the scope for such practices...until they are exposed! Similarly, declaring true turnover and profits could yield much higher benefits to an enterprise than pursuing 'informal' business. The concomitant resort to informal financing could be killing. Duty and tax evasion and exploitation of unorganised labour by trying to skirt the rigours of the Factories Act, for example, are effectively hidden subsidies... and unsustainable. Can India really slap anti-dumping charges against competing nations in such circumstances? An industrial counsellor has to play a critical role to facilitate a paradigm shift among small enterprises in this regard.

In the 'global village' of the day, international competitiveness is the key. As policies serve as a catalyst to encourage necessary upgradation of an enterprise, counsellors need to work more closely with policy makers and industrial associations. A relevant requirement is for industrial counsellors to work with small enterprises to facilitate a paradigm shift towards pursuing 'formal business'. Necessary professional inputs have to be provided.

Professionalism in Management and Formalising Business Operations

Greater professionalism in management is also necessary for the survival of Indian small enterprises. Diversion of working capital to finance the creation of fixed assets is a common means to avoid cumbersome procedures and unrealistic margin and collateral requirements in seeking expansion funds from term-lending institutions. Enterprises pursuing such diversion options often find themselves strapped for cash. This leads to their approaching 'shylocks' for short-term finance. Few ever get out of the vicious debt trap! Professionalism in management in terms of ideal capital structuring of projects through a proper debt-equity mix is hardly given a thought. The cost structuring of projects and, the make or buy (source) options are hardly accorded the priority they deserve. A product-mix or contribution analysis is invariably unheard of. Pricing is often based on thumb rule in both the domestic and export markets. Every cent counts in the cost conscious and increasingly competitive markets. Some small entrepreneurs are very street smart when it comes to over-invoicing exports for incentives and 'drawbacks', under-invoicing to reduce the burden of customs tariffs in importing countries, or exploiting the Advance Licence mode for duty-free import (and,

profitably dumping products in the domestic market). But they remain ignorant of their cost structure. A management which has its foundation in financial opaqueness and on exploring means to avoid, if not evade, statutory liabilities and dues is hardly sustainable. Balance sheets are often ridiculously dressed down to minimise turnover and profit-related duty and tax liabilities. Turnovers of successful and the typical de-facto 'larger' small enterprise units may be 5 to 10 times of the declared figures. Informal finance and 'black money' may run the show. A Technology Upgradation Fund (TUF) scheme at a lending rate of 8 per cent cannot be availed of. Ignoring the cost of capital advantages of formal finance could eventually make a growing enterprise uncompetitive. Entrepreneurs need to be made aware of the modes of adopting professionalism in management and the advantages and modes of formalising operations and financial statements. Counseling on these fronts is an obvious imperative.

Forward and Backward (Vertical) Integration and Other Networking Options

Integration, both forward and backward, is necessary for sustenance in most sectors. The best examples are provided by finished leather manufacturers integrating into small leather goods manufacture catering to the domestic complementary goods market, and leather garment and shoes manufacturers sourcing specific varieties of raw material hides and skins by means of joint ventures in the CIS, Middle East and East Africa. It is not uncommon to find small marine product exporters in Veraval sourcing shrimp or lobster from projects in Bangladesh, knitwear manufacturers in Ludhiana effectively sourcing yarn from Australia, or surgical gauze manufacturers in Rajapalayam procuring raw material cotton from East Africa, either

independently or jointly. However, it is hardly necessary for a firm to set up integrated manufacturing and service facilities to ensure a reliable flow along its supply chain. The relative absence of domestic (Indian) machinery manufacturers in clusters of such enterprises, for example, has hardly affected enterprise performance. Business risk is in effect reduced. The decision on integration vis-à-vis subcontracting depends on whether the objective of the promoters of an enterprise is to enhance margins or reduce risk in quality, and is determined by availability of supplies and potential fall in demand. Counselling on such issues and identification of the 'optimal' extent of integration that may be pursued by a small enterprise in a sector is critical. Many product categories, such as those in the textile and leather product sector in India, survive on the basis of tariff barriers against imports from Vietnam, China or Thailand.

Locally available raw material may be extremely costly but protected by import tariffs. Forward integration as to directly export and integrating backward thereby importing and processing duty-free raw material may be an imperative in many cases. The franchise route is an obvious option for a small firm strapped of resources for market development to grow in scale and establish a brand name for a product form or variety sold often on the basis of 'notional differentiation'. If a McDonalds, Van Heusen or Aptech can grow from tiny units to megaliths, there is no reason why other small enterprises cannot network to adopt this strategy to develop a brand, create reliable market channels and greatly enhance their scope in terms of dispersion of points of sale. The San Daniele ham consortium of enterprises in Italy serves as a demonstration model for such a marketing consortium.

<p>Forward and backward integration viz., into raw material purchase and more direct marketing, for instance, may be necessary to reduce production costs to international</p>
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standards and also secure reasonable margins. The decision of integration vis-à-vis subcontracting needs to be made on the risk versus return perception of an entrepreneur. Optimal integration may be possible by a group of enterprises working as networks on these fronts.

Counselling in such areas will help thwart the possibility of Indian consumers, for instance, taking to Chinese textiles and garments following progressive reduction in customs duties warranted by the WTO and the IMF. Counsellors to both private and public business development service providers (PPBDS) serve as catalysts to revitalise small industry. This book essentially serves to highlight and elaborate on the broad scope for such counselling intervention even while indicating policy orientation to facilitate the same. Policy makers have a critical role to play in tandem with effective industrial counsellors!

The Synergistic Role of Policy Makers and Industrial Counsellors

The case of the auto-component sector in Chennai offers an illustration about the need for synergised efforts between policy makers and counsellors.

The State of Tamil Nadu has been relatively successful in the promotion of foreign direct investment (FDI). FDI, essentially foreign savings, is expected to effectively enhance growth in state gross domestic product given an Incremental Capital-Output Ratio (ICOR), which is a constant, at least, in the short run. However, FDI need not necessarily reflect on enhanced scope and potential for smaller (potentially vendor) enterprises or the domestic industrial sector.

With several global auto majors having established production centres in Tamil Nadu with the policy sops and infrastructural strengths of Chennai, it was expected that the auto components industry spread across the state would benefit. However, while some larger companies have benefited, most smaller enterprises remain in the doldrums. Tamil Nadu has always had a strong base in the auto components industry with the state manufacturing about 35 per cent of all India production of about US\$ 1 billion and contributing to about 50 per cent of exports. Three large local component manufacturing groups contribute to more than a quarter of all India automobile component requirements. The auto component industry in Chennai was believed to be in the threshold of expansion with Ford, Mahindra, Hyundai Motors and Mitsubishi setting up shop. However, smaller enterprises in the region have largely been bypassed. The mother units prefer other vendor bases abroad to Tamil Nadu. The domestic auto-component manufacturers have not been developed as to serve as an effective subcontraction pocket. Small and medium enterprises (SMEs) could have come together to offer the critical volumes and specifications required.

Adoption of new technologies, reduction of costs by establishing 'raw material banks', upgrading management, betterment of quality standards and standardisation of prices as to effectively tap the demand of MNCs and large players remains to be pursued. It is an opportunity that has not really been exploited. While policy makers had roped in the auto majors, local industrial counsellors who could have helped effectively develop potential vendors failed to contribute to effectively help the vast majority of domestic enterprises to exploit the opportunity.

Chapter 2

Scope of Industrial Counselling on the Management Front

Small businesses in India generally operate on the basis of mere arithmetic in different functional areas. The orientation is more operational than strategic; more book-keeping and 'thumb-rule' based than professional. They do not tend to use management tools. An industrial counsellor needs to develop two skills for appropriate and efficient counselling in management of a business to facilitate revitalisation in an increasingly competitive environment. The first is the need to develop a frame of reference viz., what are the best practices in different functional areas adopted by other enterprises, in different parts of the country and the world; and the second is to devise appropriate tools of business analysis and management. There is a dearth of both in Indian small business. There is a dire need to upgrade management in order to efficiently utilise appropriate management tools in various functional areas of a business. Competition is not only in terms of financial or marketing muscle of foreign competitors but also in terms of efficient management at

the enterprise level. A counsellor has a critical role to play in this regard.

The Industrial Structure Circumstance of the 'Beautiful' Enterprises

Small enterprises may remain 'beautiful'—a view popularised by the economist Schumacher—and may sustainably meet competitive challenges as indicated by Michael Porter depending on their potential to develop a relative advantage in terms of (1) a cost advantage, (2) a differentiation advantage in terms of real value-added products or services—which may imply 'better' services or price discounts or credit offers, or a differentiation advantage in terms of notional differentiation (such as) a brand, or (3) an ability to focus on a niche market. The last may include targeting a low volume and customised product requiring market segment, or operating in a fragmented market. Strategy formulation for a small enterprise will vary based on the above. As indicated in the previous section, while a small enterprise may be of a sustainably ideal size on the manufacturing front as in the case of enterprises in sub-sectors of engineering, seafood and plastics, they may not necessarily be of ideal economic size on the marketing and raw material purchase front. Scale economies may be low on the manufacturing front but may be significant on the input (and wherever necessary, import) purchase and marketing front. The benefit of cash, bulk and appropriately sourced raw material for polymers or chemicals and dyes is not adequately exploited making them uncompetitive. Similarly, the financial muscle required to market products either in terms of credit terms viz., channel motivation, or investing in developing a brand is inadequate. This indicates the necessity for small

enterprises to explore options to work with other enterprises to create hard networks or consortia in these two areas. Management upgradation by means of counselling on such options is a necessity.

Similarly, management upgradation is required in different functional areas of enterprise operation so as to analyse relevant areas of finance, marketing and production while strategising action or revitalisation plans to face the challenges of tomorrow. This is particularly necessary to sustainably survive in an era of market reform and increased external competition. Many enterprises remain ignorant of the imperatives. Counsellors need to ensure that small entrepreneurs and their personnel have sufficient understanding of business operations and the ability to make relevant analysis. They should learn to perform a meaningful SWOT (Strengths–Weaknesses–Opportunities–Threats) analysis of their enterprise and understand real problems and opportunities, and, efficiently strategise and structure operations.

A small enterprise is sustainable if it can develop a cost advantage, a differentiation advantage or a niche market vis-à-vis its competitors. With regard to the first two options, they need to form 'hard networks' in order to achieve necessary scale.

Analysis of Business Operations and Evolving Revitalisation Plans

The debt-equity mix in the composition of capital of an enterprise or its business plans is invariably decided on the basis of risk averse or risk-oriented nature of entrepreneurs. It is also decided on the basis of available resources to offer as contribution, project cost and norms

of financial institutions. This is done after accounting for subsidies and other relevant incentives available, if any, so as to reduce burden on promoters' margin and interest obligation on future operating cash flows. However, aspects such as financial leveraging benefits are often ignored. The extent of debt secured should be optimised based on the return on investment and rate of interest differential, as also the tax rate. The advantage of tax shield on interest is hardly realised by enterprises and promoters who pay or are likely to pay high levels of corporate or personal income tax. The potential rate of return on equity with improving sales realisation is also lowered as the benefit of aggressive financing is not optimally availed of. Analysis forecasting tax and interest rates is also forsaken. In Tirupur, for instance, the average textile exporter loses tens of lakhs in terms of income tax and opportunity cost of own funds. This may be avoided by merely going in for institutional working capital rather than using own funds. This is but one illustration of the situation that arises when promoters do not give due consideration to scientific risk-return analysis.

When assessing working capital requirements, most small manufacturers, product manufacturers and exporters do not estimate the Economic Order Quantity based on essential inventory management principles of raw material ordering and carrying cost. The benefits of bulk and cash purchase of raw material from within a cluster or region, say for natural fibre by Kolkata-based jute units or for chemicals from Ahmedabad or abroad, through a consortium mode is also rarely considered. Such options that reduce the cost of production and the cost of locked up or inefficiently managed capital on the inventory front are ignored. Besides inventory management at the enterprise level, small units must learn to exploit the ideal size of purchase itself (perhaps on a consortium basis) in order to optimise the benefits from discounts for ideally procured cash and bulk purchase. Both input costs and implicit or

explicit cost of working capital may be reduced by identifying the optimal volume and sequencing of purchase. Most small enterprises face a cash crisis. It is almost a matter of habit among smaller enterprises to resort to costly 'informal finance' to tide over this crisis. Elementary cash flow management systems are ignored. The 'current ratio', for example, is sometimes employed by 'larger' small enterprises to analyse if levels of liquidity in an enterprise are acceptable. However, the levels of liquidity can hardly be estimated on this basis. Therefore, quality of assets and inventory and stock turnover ratios are sometimes simultaneously incorporated over relevant audit. Entrepreneurs may have a reasonable understanding of such concepts to identify real problem areas. Such analysis could help narrow down weaknesses in operation, but not necessarily offer modes for efficient or sustainable performance. The utilisation of simple related systems such as a 'cash flow cum cost' recording statement to decide on both the ideal selling stratagem in terms of discount and credit and the ideal fixed or variable cost structuring of cost of production related expenses is invariably unheard of. Therefore, the scope for efficient, integrated, liquidity and sales management as well as ideally tapping scope for enhancing profitability is effectively ignored. Further, analysis of problems and identification of opportunities to reduce financial problems of an enterprise suffers. Interventions on the systems front (if at all) are invariably on standard ISO-related implementation. These are areas that require upgradation.

With regard to business plans, elementary but conceptually sound methodologies are invariably ignored. Business risk is evaluated in terms of the selling price or output changes, but, hardly in terms of operating leverages or financial leverages, which effectively help in optimal structuring of costs and capital. Businesses and plans fail or succeed more by these factors than by ever increasing levels of 'cost-based' competition or market recession.

The capital structuring of a business and its plans, analysis of working capital requirements on the basis of ideal purchase and inventory decisions, efficient liquidity management and evolution and implantation of appropriate management systems for efficient decision-making are all critical requirements. Indian small industry virtually operates in a vacuum in these areas!

Upgradation on the Marketing Front

The 'cash cum cost' sheet introduced earlier is a systems targeting management tool that could also help in the formulation of discount versus credit decisions. However, the scope for customised development of such systems that could be employed in marketing strategy formulation is not realised. Conventional 'contribution' analysis to explore product-mix and selling incentive decisions, and trends of management accounting related debtor turnover ratios, for instance, to assess performance and problem areas are tools that are sometimes employed. However, they serve more to evaluate performance than enhance it. Management upgradation through counselling on the marketing front to incorporate such customised systems is required.

An integrated approach to marketing is not evident among most small enterprises. Upgradation of entrepreneur skills in integrating production structure, finance structure and pricing or marketing could help improve performance in enterprises. 'Thumb-rule' based pricing and selling stratagem need to be avoided if enterprises are to sustainably survive. A counsellor needs to understand the modes of integrated business counselling and offer the same to enterprises.

The incorporation of management principles coupled with 'network' development could help in cost reduction. This area is conventionally targeted by process

or equipment related technological interventions. However, the mere formation of hard networks along the supply chain in the case of yarn manufacturers, coir product manufacturers and exporters in Alleppey on the basis of optimal purchase volumes could ensure a reduction in output cost. A 'combined' vertical (along the supply chain) and horizontal network (of similar enterprises) model approach among enterprises based on ideal economic size in purchase and sales functions could help enterprises in the coir sector achieve ideal scale of operations on these fronts. This could enhance sustainability of operations and cost competitiveness in a challenging environment. A network of small merchant exporters could source about Rs 2 million worth of input from a network of small product manufacturers who, in turn, source a similar volume from yarn suppliers. It is found that a quantity discount of about 4 per cent may be secured along the supply chain.

Essential tools such as the product life-cycle framework and fundamentals of the theory of competitive advantage and strategy (presented in the first section of this chapter) may be employed to lend greater professionalism in the management of enterprises. Such scientific tools, which have been empirically standardised, are often neglected by small entrepreneurs.

Management Upgradation on the Production and Labour Front

What is the optimal size of an enterprise? An important parameter that will decide this is the optimal unit cost of production or cost per unit of output. In a fragmented market or in enterprises relying on a notional differentiation (brand) or niche market-based strategy, it may not matter if unit costs are on the higher side vis-à-vis competitors. However, in the case of an enterprise which

manufactures standard products such as leather jackets or jute mattings in a free market regime, it is essential to estimate the optimal size of capital investment and subsequent annual fixed costs. The optimal size of an enterprise at optimal investment levels and operating costs are structured efficiently if the unit cost of production is minimised. A rather curious phenomenon is the preference that both entrepreneurs and their term lenders display towards a project with a low break even level of activity even in a rapidly growing industry. Potential earnings with increase in sales realisation are being inefficiently exploited. There is evident need for counselling in this area.

Decisions about whether or not a unit should be highly leveraged in terms of fixed costs vis-à-vis variable costs (operational leverage) could affect the profitability of an enterprise. The crux lies in the analysis of the potential growth rate of an enterprise and its trend and relating the same to its fixed and variable costs. Labour, finance, raw material purchase and most other expenses may be converted from fixed to variable and vice-versa. These are essential concepts that need to be imbibed by the management of a small enterprise.

Counsellors specialising in specific functional areas of business management need to develop a more integrated perspective to effectively contribute to an enterprise. Elementary but critical concepts such as operational leveraging invariably remain 'unknown or misunderstood territory' for entrepreneurs, bankers and consultants!

An Introductory Case of Surgical Textiles Enterprises Standing up to the Chinese Goliath?

Analysis of business operations and management is a skill that requires insights into analytical tools and

enterprise dynamics. Business analysis and planning may otherwise yield misleading indications on identifying problems or target areas for intervention. In the first instance, entrepreneurs need to explore the scope and modalities for collaboration in the areas of raw material purchase, marketing and establishing a common facility centre for technological support. Management upgradation in terms of 'awareness' of such issues is an imperative. Industrial counsellors have a critical role to play in this regard. In some cases, smaller players should weigh the option of pooling their resources to establish a manufacturing facility of more optimal size. Equally important are other essential concepts briefly introduced in this chapter. Management in small enterprises require counselling incorporating appropriate analytical modes in different functional areas of inter- and intra-firm operations. As an introductory illustration, consider the surgical textiles enterprises in Chathrapatti, near Rajapalayam in Tamil Nadu. The town of Rajapalayam situated about 90 km from Madurai in Tamil Nadu is famous for its mangoes. It is also a cotton-growing region and cotton varieties cultivated here are used for spinning. There are a number of spinning mills in the region manufacturing and supplying 10s to 100s count yarn all over the country. Chathrapatti is a few kilometres away from Rajapalayam. The village focuses on manufacturing and supplying surgical textiles to the Indian medical sector. This is the only region where surgical textiles are manufactured in India. Earlier, these were manufactured on handlooms. Powerlooms have replaced handlooms in the last two decades. Grey gauze cloth is exported all over the world from Chathrapatti. The region competes with China, the only other country that manufactures gauze cloth.

The enterprises in Chathrapatti are facing intense cost competition from China in recent years. The small exporters in the region specify a minimum quantity required per order for free on board destination as

Rs 4,000 (net) worth of cotton, wool, gauze and bandages. These enterprises need to understand that the same concept of minimum order size as well as 'optimal' order quantity also prevails for ideally sourced (or, imports of) inputs to effectively reduce costs. The ideal size of purchase itself may be exploited on a network or 'consortium' basis. This is particularly required for purposes of cost-effective imports.

Similarly, a handful of larger manufacturers and exporters in Chathrapatti contribute to most of the export and production of surgical gauze cloth. The cost structure of even these well-established and 'medium' sized players indicates poor margins in recent years. Consider the circumstance of Nichu Enterprises which exports about Rs 600 million worth of products every year.

Table 2.1: Annual Expenses of Nichu Enterprises, Chathrapatti, Tamil Nadu

<i>Important Heads of Annual Expenses</i>	<i>Annual Expenses as a Percentage of Turnover</i>
• Raw material	70%
• Power	15%
• Labour	10%
• Freight, etc.	5%
• Adm.OH	2%

Table 2.1 indicates that the annual expenses of operation exceeds the sales realisation secured by enterprises in this export-oriented sector. However, the Duty Entitlement Pass Book Scheme (DEPB) benefit for this exporting enterprise is about 5 per cent and, hence, net margins equal 3 per cent or about Rs 18 million. The operation cycle of this enterprise is about three months. The enterprise largely imports cotton and spins yarn at its own spinning mill. The raw material stocking period is for

a period of two months and work-in-process period is of about one month. Ideally, a working capital facility of about Rs 80 million is required for this enterprise. However, the enterprise uses a facility of only about Rs 45 million. About Rs 35 million of own funds is also utilised. This is in effect a cost. The opportunity cost of own funds of about Rs 3.5 million per annum, and income and export tax of about Rs 2.8 million that the enterprise pays may be saved. The income tax/export tax obligation may be reduced by the interest the enterprise pays on the working capital credit facility that may be enhanced to about Rs 80 million. As a matter of fact, in spite of investing in 'depreciation' by means of expanding fixed assets, the enterprise paid income tax of about Rs 2.8 million. The net benefit by enhancing the limit and paying relevant interest @ about 8 per cent (pre-shipment credit rate) is, therefore, about Rs 3.5 million. Profit margins of this enterprise may be enhanced by about 15–20 per cent! Hence, a circumstance of 'poor margins' may not be only due to cost competition from abroad but equally due to absence of adequate knowledge of elementary business management principles. The ideal size of purchase in the case of this enterprise is estimated to be three times the current level. Consortium based (import) purchase linked with similar enterprises could help increase net margins on sales by another 2 per cent!

In elaboration, for larger exporters in the sector a critical survival option is to import inputs (duty-free or otherwise depending on comparative benefit in terms of DEPB rates) viz., cotton based on relative price (and monsoon) circumstances between India and East Africa. Sourcing chemicals and dyes, not locally, but from Ahmedabad in order to facilitate reduction in relevant costs is an option the enterprise has been pursuing. However, networking with similar enterprises to import larger volumes of cotton so as to avail of bulk discounts and exploring sourcing options from smaller chemicals and dyes suppliers from Ahmedabad or importing such inputs

from South Korea could further reduce relevant transport costs and help the enterprise secure higher quantity discounts. Further, as this example illustrates, management upgradation in terms of capital structuring and estimating the consortium based EOQ remains equally critical.

Prior to internalising the major aspects introduced in Chapters 1 and 2 in detail, it is necessary for a counsellor to develop insights into entrepreneur-enterprise typologies in terms of performance and growth orientation. The following chapter presents insights into the facilitating and hindering factors for the growth and graduation (to medium scale) of small enterprises and their entrepreneurs in the country.

Chapter 3

Entrepreneur Perceptions, Enterprise Typologies and Growth and Graduation Motivators of a 'Successful' Small Firm

There has been very little academic work exploring either the ways in which small enterprises are able to realise their potential for sustainable development or, how these might be overcome. It is necessary to understand firm-specific dynamics affecting development of a small enterprise in the context of the Indian business and economic environment.

Understanding the Factors Hindering Sustainable Development

Much of the relevant academic research displays a common bias: considerable attention has been paid to the

process of start-up and 'teething' problems, rather than to constraints faced in achieving sustainable development. The issues of finance and managerial skills have been studied in the arena of small business research, at least in the international context. However, little focus has been accorded to the more dynamic aspects of how these and other factors interact as an enterprise grows in size. There have been studies on small firm performance and growth subsequent to start-up. A variety of factors have been analysed, including: (1) the relationship between entrepreneur profile and financial performance of an enterprise, (2) willingness on the part of an entrepreneur to grow his enterprise, (3) the role of managerial skills, (4) the impact of geographical location or 'clustering' and the relevant economic and industrial environment. However, limited research has been pursued on the specific issue of barriers to sustainable growth and development, particularly in the Indian context.

The start-up phase of small enterprises has been extensively researched, not their performance, growth and sustainable development. Studies on factors influencing small enterprise performance in terms of entrepreneur motivation, managerial profile and geographical agglomeration have largely been carried out in the developed countries.

Two questions of critical importance are: Why do some small enterprises grow sustainably and not others, and what are the relevant dynamics and imperatives? It is, therefore, necessary to understand the barriers to growth experienced by established Indian small firms. This will serve as a frame of reference to the catalyst, an industrial counsellor, in facilitating sustainable development or revitalisation of small enterprises as to effectively thwart international competition. This will, in effect, support the process of:

1. Profiling enterprises in terms of their circumstance and functional strengths, and examining the performance and potential of an enterprise through an analysis of intra-firm and inter-firm relationships.
2. Helping evolve revitalisation plans for enterprises.

Review of Research Approaches to Enterprise Development

Approaches to enterprise development have been policy focused, both enterprise level and economy or sector focused, personality dominated, and business management focused.

The Policy Context: Picking Up the 'Winners'

Over the last few years, policymakers in India have been focussing greater attention on well performing small enterprises rather than on creating new ones. One reason for this thrust on identifying and working on potential 'winners' is the scarce resources available at their disposal and the reforming banking system which is over burdened with non-performing assets. The focus has been on identifying sectors and enterprises that have high foreign exchange earnings, employment and competitiveness with minimum resource cost. In the Indian context, the shift in policy focus reflects a number of aspects including:

- A greater emphasis on efficiency than mere generation of employment alone.
- A realisation of the scope for sustainable competitive advantage of small enterprises particularly those

existing as clusters in sectors such as gems and jewellery, leather/leather products, and textiles.

The Enterprise-level Approach

This includes approaches exploring the role of characteristics and competencies of an entrepreneur and approaches that focus on the importance of business skills and efficiency of functional management in an enterprise.

In characteristics and competency-dominated approaches, an entrepreneur is seen as the key to performance. An entrepreneur is a risk taker and bearer of uncertainty and an organiser of the factors of production. Competencies of the entrepreneur are accorded prominence. These are linked, in turn, with the performance of an enterprise. They are rather akin to the behavioural trait and achievement motivation models of McClelland. However, the attempts to link high scores on behavioural 'traits' associated with motivation to performance is hardly conclusive. McBer and Company had undertaken a major study for the Agency for International Development (USAID). The study explored the relationship between entrepreneurial competencies and business performance in several Third World countries. The McBer report established such a relationship. Nevertheless, a review of the data of the USAID study indicated that personality variables are not necessarily useful predictors of business performance. Conflicting research evidence therefore exists on relationship between performance and risk-taking propensity.

Behavioural characteristics and competency-based models linking personality variables to enterprise performance do not display conclusive evidence between performances, need for achievement, and the propensity for taking risk. Other variables may also play a significant role.

What is also evident is that the profit-maximising objectives of economists seem rather simplistic. Small entrepreneurs may not always have the intention to increase activity levels. Limited ambition and the tendency to avoid loss of control are also factors that affect the growth of small enterprises.

Management approaches focus on skills on functional management areas. Some approaches to predict performance on the basis of accounting ratios have focused more on the 'impact' than on the cause. Such studies also stress on problems faced by small enterprises in securing debt capital from formal term-lending institutions given the latter's worry about the time involved and monitoring of small loan appraisal. Such models also criticise the 'just-in-time' and sub contraction modes of large firms as large enterprises may use small ones as a means of managing their own liquidity by delaying payment or passing stockholding to small enterprise suppliers or consumers.

Functional management skills coupled with the inclination to provide financial and other (perhaps 'stocks') related information to institutions play a vital role. Profit motive is not the only mission of an entrepreneur!

Similarly, industrial economic and sectoral approaches focus on sectoral growth models and on 'clustering' and locational impact on performance.

What Does the Literature Say?

The literature basically indicates that actual performance is also a function of entrepreneurs' ability, opportunity and growth motivation. Counsellors should realise

this fact. The sector of activity and potential to reap scale economies also determine potential for growth. The characteristics, competencies and willingness of the entrepreneur and specific industrial structure determine actual growth. The characteristics of the entrepreneur may refer more to entrepreneur willingness and ability to grow in scale and graduate beyond the small-scale category. Enterprise-specific features are shaped more in terms of a unit possessing a niche market, formulation of a formalised business plan, effective support in the form of institutional credit and the existence of scale economies in industry. In the Indian economy, environment-related issues in terms of policy incentives for the small units may also serve as implicit disincentives to grow in scale. Entrepreneur typologies given enterprise and environment related features may serve as determinants with regard to relative internalisation or externalisation of hindering and facilitating factors for growth and graduation.

A study (1989) pursued by the Entrepreneurship Development Institute of India under the aegis of the Industrial Development Bank of India (IDBI) indicated that the entrepreneur's intentions, intra-firm imperatives on the finance front, in particular, and support system incentives emerge as key factors that influence sustained performance, growth and graduation (beyond small-scale categorisation) of even a 'successful' small enterprise. A summary of the findings in the literature and of the EDI study is presented below.

Growth Intention and 'Managerial Control'

Few entrepreneurs have an objective to maximise growth in size and scale of an enterprise. The attitude to growth is affected by the worry about risks that may accompany growth. Moreover, there is a worry of the

trade-off that has to be made between potential turnover growth at the expense of short-run profitability due to lags in return on capital in some cases, and a fear of 'loss of control' from the psychological point of view on the part of the owner-managers, with professional managers handling operations. Growth, per se, is also constrained by worries about handling higher activity levels and possible loss of control in this sense. Graduation, on the other hand, is constrained by possible loss of advantages in remaining as a small-scale unit.

The need to maximise growth is hardly an overriding ambition. The entrepreneur would like to remain 'boss' and not develop a management team that has the potential of challenging the performance or style of the 'boss'. In the context of small enterprises, a growth-maximising assumption cannot therefore be made. Such an attitude serves as barriers to growth.

It is not the availability of finances per se that constrain growth in the case of such entrepreneurs, in the SSIFS (factory sector). Rather, it is a deep-rooted reluctance to use debt to finance operations of the enterprise vis-à-vis short-term working capital requirements, or to take on new equity and thereby dilute control of existing equityholders. A strong preference to fund expansion out of retained earnings and achieving a degree of financial self-sufficiency is indicated. While confronting the choice between using external financial resources to maximise performance as against constraining it to a rate compatible with retaining financial control or also minimising financial risk, some entrepreneurs may opt for the latter. Growth is thus discarded in favour of financial self-sufficiency. The advantages of trading on equity, in fact, are hardly realised even among well-educated entrepreneurs. The advantage may be minimal if declared profits are minimised by various means. However, even those few whose transactions are mostly 'above board' hardly realise the benefits of the tax shield on debt-financed

profits. Faster growing and graduated enterprises have taken increasing recourse to the debt route while others have not.

Fear of 'loss of control' with higher activity levels or with professionals handling operations indicate disinclination to lose managerial control. Similarly, the fear of loss of financial control by virtue of seeking outside finance serve as barriers to growth for some. These are barriers internal to the entrepreneurial psyche. This is one entrepreneur-enterprise typology.

Financial Control in Terms of 'Management Control' and Commitment to Growth

An entrepreneur may be in a quandry (a) to develop the business, or (b) to retain financial control (in terms of management control). Some promoters would not like to lose control on business decision-making to bankers, for example.

Resolution to Grow

In many instances, there is a reluctance to grow that stems from a fear of the risks of growth, including the fear of losing managerial control combined with a desire to use the business simply to support an established lifestyle rather than generate maximum revenues. For some entrepreneurs this may be overcome by motivational training and counselling and also by highlighting the medium- and long-run unsustainability of maintenance of status quo.

Financial Control in Terms of Foresaking 'Transparency'

Many units pay scant regard to the need to prepare a presentable balance sheet of the business unit. The personal/family bank account or 'assets' are given primary importance! A history of financial statements with understated turnover and returns for duty benefits and with equity being replaced by unsecured loans for tax benefits would hardly attract funding when required even by a banker in the 'know'. This is particularly true amongst entrepreneurs who are reluctant to grow in scale and have not graduated viz., those in the non-factory sector (with less than eight full-time salaried employees).

Amongst enterprises who have *de-facto* grown continuously, few have graduated (vertically). A widely accepted phenomenon of horizontal growth in terms of setting up of sister concerns, often under different management on paper, is validated. Growth inclined and 'experiencing' entrepreneurs have not graduated for purposes of tax management viz., by manipulating input/output 'book' costs and prices for duplicatory apportionment of overhead expenses and, to avoid falling under higher excise duty slabs; or, to avoid coming within the purview of the Factories Act. Sister concerns have, therefore, been initiated. Entrepreneurs in this typology, in fact, often remain in the non-factory sector (NFS) category.

Trade Off Between Control and Growth

The willingness to forego growth in favour of maintaining financial self-sufficiency, 'secrecy' discretion or non-transparency and managerial control inevitably limits the performance, growth and graduation of small firms. Enterprises in many cases eschew relatively

attractive working capital from financial institutions merely to keep true turnover figures and activity levels under the wraps. Many small entrepreneurs prefer to retain independence to operate a firm's account and their personal account without reporting plans to a banker. Sometimes, however, the issue of 'financial control' is more with regard to psychological aversion towards employing or 'risking' others money!

Informal business, evading statutory norms and dues, non-declaration of statutory information and avoiding coming under the Factories Act characterises another typology of non-graduation inclined entrepreneurs. A third typology includes those who have adopted the 'horizontal' route to growth. The hindering factor to growth and graduation is more external to the entrepreneur and his enterprise in both cases.

Managerial Style

In the absence of efficient management, entrepreneurs become engrossed in day-to-day affairs of coordinating the business. A small entrepreneur is closely involved in all aspects of the business and is preoccupied with immediate, short-term issues or problems with little emphasis on long-term planning.

Market Demand and Trade Finance

Most small enterprises are dependent principally on the domestic market. The market recession in the last few years has been a barrier to growth (if not graduation!). Bad debts have increased. The period for meeting

obligations to sundry creditors has necessarily decreased while that for realising payments from debtors has increased. The usual mode of funding operations from trade credit is becoming difficult to employ. Increasing levels of competition only worsens the scenario.

Balancing Internal and External Factors

Some entrepreneurs often ascribe lack of growth to external factors. Barriers to growth are, therefore, externalised and, present an image of an enterprise being dependent on factors beyond its control. One external constraint predominates the scene viz., the protected small industry environment with its incentives and also related government monetary and fiscal policy. What is obvious, however, is not the existence of external constraints alone but both internal and external barriers to growth. A central proposition of this is that, in the long term and the case of enterprises in the SSI(FS) category in the upper extreme of SSI investment limits, it is internal rather than external barriers that exert the decisive influence upon a small firm's growth and graduation. In the case of SSI(NFS) units viz., those towards the lower end of the scale spectrum, the barrier is more external. Internal barriers are not only enterprise techno-economic or industry sector specific but, more importantly, relate to attitudes and perceptions of owner-managers of small firms towards growth.

Reconciliation Between Divergent Attitudes and Aspirations

Understanding growth and graduation entails reconciling the potentially divergent attitudes and aspirations of graduated and non-graduated entrepreneur-enterprise

typologies [in the SSI (FS) and in the SSI (NFS)] and between those with growth motivation and those without. There is a range of issues over which opinions held by these typological groups of enterprises typically diverge. For example, the need to grow, particularly in terms of increase in turnover or investment in plant and machinery; the risks associated with growth; and the scope for using external finance to fund growth. Disagreement over these fundamental issues is characteristic of small enterprises, between graduated or 'willing to graduate', and non-graduated or 'non-willing to graduate' types of entrepreneurs. The failure to reconcile these views and evolve a shared long-term view on growth or graduation affects policy initiatives. Those who have graduated would, for obvious reasons, prefer a continuous increase in investment ceilings and all support incentives related to duties and manpower legislation. However, entrepreneurs in this category must realise that the same would be an inefficiency-breeding strategy to encourage growth in scale of small enterprises. Such an approach would also be detrimental to the interests of the genuine smaller enterprises at the lower end of the spectrum and could affect growth in the number of smaller SSIs. They would not have the minimal support and protection to initiate and stabilise in the face of competition.

A counsellor needs to understand that to sustain performance and growth the entrepreneur who started and initially built the enterprise is not necessarily the best person to expand its scale of operations. A reconstitution of management from being a sole proprietary to partnership enterprises to private limited enterprises and, if necessary, public enterprises may be necessary. Financial institutions prefer funding private limited companies with a good management team. Therefore, it may be imperative to target enterprises for counselling that can ensure a transition towards professionalism in management through a suitable change in the constitution.

Sustaining performance and generating growth warrants that day-to-day operational activities do not absorb the greater part of an entrepreneur's attention, thereby narrowing focus. A prerequisite of sustainable performance and growth is, therefore, the utilisation of competent industrial or business counsellors to facilitate performance evaluation and preparation of revitalisation plans.

Counsellors can help small firms develop managerial skills, and induct efficient systems. They can also broaden the perspective of an entrepreneur with the changing requirements of the environment. A counsellor may be a private Business Development Service (BDS) provider or a public BDS provider representing a developmental or support institution such as an official of the textiles committee (ministry of textiles) or the Coir Board.

Policy to Instil 'Growth' Motivation in Small Business

The policy priority should be to eliminate internal barriers to growth (in size and scale) and simultaneously create a proper climate to eliminate implicit policy disincentives and ensure a favourable fiscal and monetary policy. It is necessary to upgrade management by means of supporting project/market/systems and get financial counsellors to work alongside small entrepreneurs to enable these enterprises to survive in a reforming Indian economy and increasingly integrate them with the competitive global market. The competence, confidence and motivation to keep growing in scale to graduate beyond SSI categorisation need to be strengthened. Units in the SSI (FS) category are typically characterised by levels of investment

at the upper end of the SSI investment limit. Many of them require growth and graduation motivation to be instilled into their psyche. The fear of losing control, sharing equity and management control with other partners and professionals and assuming the risk of handling higher activity levels needs to be removed from the mindset of the 'comfortable' small business entrepreneur. Units in the SSI (FS) have lost most incentives available to small units, except for advantages like that of reservation. Hence, if a policy disincentive scheme for non-growth and non-graduation is implemented, it will remove only those barriers that are internal to the psyche of the entrepreneur.

A necessary option may be to implement time-bound policy disincentives to remain small or non-graduate. Basically, this will remove external barriers to growth. Enterprises could be granted a time frame of a decade or more from inception to enjoy the benefits of small industry categorisation. Beyond this period, they should be allowed to compete with other units large and small without preferential treatment. This could serve as an encouragement, particularly for enterprises in the small scale industry (SSI) non-factory sector (NFS) to keep growing in terms of investment in de-facto and declared investment in plant and machinery viz., facility expansion and upgradation, declared turnover and declared manpower. Inefficient fragmentation of units and the phenomenon of horizontal growth in the SSI sector could be curbed. SSI(NFS) units may be encouraged to grow into SSI(FS) category and eventually graduate. Tiny sector units may be exempted from this 'penalty' for declared or undeclared non-growth from the point of view of social benefit. For gradulators in each phase, preferential interest rates on debt capital and, more importantly, compromises in collateral requirements of funding institutions may be offered as a one-time incentive. The National Equity Fund (NEF) scheme of Small Industries Development Bank of India (SIDBI) is a start in this direction as also its Credit

Guarantee Scheme. Enterprises in the reserved category may be permitted to graduate and continue growing in size. If the policy of immediately phasing out benefits for existing small enterprises is 'difficult' to implement, it may be declared for at least new enterprises being initiated in the SSI sector.

Time-bound policy disincentives to remain small, either in 'declared' terms or otherwise and, enforcement of voluntary disclosure schemes of employment, turnover and income levels could remove external barriers. The mission of a counsellor should be to reduce internal barriers to enterprise growth. A counsellor may also use his enterprise level insights in evolving appropriate policy.

The levels of protection to SSIs in terms of excise exemption, priority and preferential credit and purchase may even be enhanced with increasing competition from abroad. But all need to be time bound in order to avoid fostering inefficiency.

A scheme similar to the income tax-related Voluntary Disclosure of Income Scheme (VDIS) may also have to be introduced. This may offer amnesty to entrepreneurs who declare 'true' data with regard to manpower employed, turnover, profits and investment in plant and machinery. Defaulters may be severely penalised upon initiation of thorough random enquiries. This could ensure that at least potentially viable and efficient units take the initiative to move on to a growth path. This will be beneficial from both the overall economic and individual enterprise efficiency point of view.

Further, legislation may be made to ensure that 'sister' concerns are not developed. The horizontal growth phenomenon could be curbed by not permitting initiation of more than one enterprise with the involvement of a

promoter (or members of the family) in manufacturing the same product line.

Leveraging debt capital and willingness and ability to make productive use of institutional support may be given priority to make growth-led gains vis-à-vis securing short-run returns by remaining 'smaller' in terms of turnover, employment and investment levels. The Indian economy cannot afford more 'sick' enterprises and requires small 'winners' who grow and sustainably develop. Industrial inefficiency cannot remain a perpetual bane to this developing economy.

The review and insights presented in this chapter are more with regard to understanding characteristics of small enterprises and exploring the scope of policy options towards revitalising 'good performers' as to facilitate their growth. The following two chapters consider cases on poor performers and on revitalisation.

Chapter 4

Factors Affecting the Performance of an Enterprise

The factors affecting the performance of a unit may often be unit specific. Nevertheless, hindering factors to performance may be similar along the supply chain. The two cases described in this section indicatively elaborates on the broad gamut of factors in these two contexts.

Case I: Profiling a Spinning Unit that was Still Born

The case of Narayan Spinners Ltd. indicates possible factors that could hinder performance of a unit. Narayan Spinners Ltd. is located at Panipat, Haryana. It manufactures shoddy yarn and has an installed capacity of 600 mt per year. The market for its product is Himachal Pradesh. The company has imported equipment from Italy and started commercial production in May 1993.

Narayan Spinners Ltd. was sanctioned a term loan assistance of Rs 6.4 million against the project cost of Rs 10 million by the State Financial Corporation (SFC) in 1991. Since the enterprise was manufacturing shoddy yarn for the first time, a 'cautious' approach to implementation was followed. The enterprise implemented the project in phases. In the first phase it installed 400 spindles along with other ancillary equipment. Initially, it pursued job work for converting local wool into woollen yarn. Work was carried out for government agencies as well as private parties. From 1991 the company started importing shoddy rags and started manufacturing shoddy yarn. The total cost of the first phase was Rs 5 million, for which the company availed of a term loan assistance of Rs 3 million from the SFC, Rs 1 million was obtained from the Directorate of Industries and Commerce (DIC) as investment subsidy and the remaining Rs 1 million was brought in by the promoters. Given the demand for shoddy yarn, the enterprise decided to implement the project's second phase in 1996 by installing more spinning facilities. The enterprise had been sanctioned an investment subsidy of about Rs 2 million by the state government for the first phase against which Rs 1 million was actually availed of during implementation.

However, the DIC did not release the balance of Rs 1 million, due to 'shortage' of funds. Since the amount was required to implement the 'second' phase, the promoters brought in Rs 500,000 in addition to their earlier equity of Rs 1 million to complete the second phase of the project. Non-disbursal of investment subsidy and deduction of outstanding dues by the SFC with regard to disbursement of term loan resulted in serious depletion of funds available with the enterprise. Inadequate working capital limit was sanctioned by the bank affecting the working of the unit. The resultant underutilisation of capacity led to losses during the following years.

In fact, the down-scaled term loan, the phased implementation of the project and non-disbursement of required level of working capital affected performance. The causes for under-performance were both internal and external.

The turnover estimates of the enterprise indicates how the non-disbursal of investment subsidy affected cash flow resources of the enterprise necessitating it to work on job work basis than with own working capital till 1996–97. Surplus to cover fixed costs was low. Table 4.1 presented below indicates the performance of the enterprise over the years.

Table 4.1: Turnover Trend of Narayan Spinners, Haryana
(Rs in million)

Year	Turnover
1993–94	0.426
1994–95	0.535
1995–96	0.560
1996–97	1.490
1997–98	1.864
1998–99	1.894
1999–2000	2.440

The devaluation of the rupee in 1993–94 increased the cost of imported shoddy rags, which was the main raw material in the manufacture of shoddy yarn. Problems were aggravated when the central government increased customs duty on the import of shoddy rags by over 30 per cent and the LC (letter of credit) margin was also raised by 50 per cent to discourage imports. As a result, the enterprise incurred heavy losses, its net worth was eroded and it also failed to honour repayment commitments.

Performance Analysis Brief: The Obligations and Causes for Poor Performance

The unit's net worth eroded over the years and was negative at the end of 1995–96. Net profit was negative due to incidence of interest which increased year after year. This was not due to additional loans taken by the unit but due to non-payment of interest on which further cumulative and penal interest was charged by the SFC. However, this also brought out the fact that increases in sales value of the unit was not resulting in profitability. This means that the selling price was not remunerative. The unit was, therefore, unable to recover the cost of interest and, therefore, its equity remained non-remunerative all these years. Additional loans for the revitalisation of the unit may further worsen the situation, as the interest coverage ratio remained negative all these years. The markets had become competitive during the last few years removing the scope for any increase in selling price. Increase in capacity utilisation and of fixed assets seem a major requirement as per the analysis of performance.

Uneconomic size of the plant?: The original project was based on about 1,300 spindles and the project cost was estimated at Rs 10 million. However, the company installed only 500 spindles in the first phase. Moreover, it could not start production of shoddy yarn as envisaged in the project and pursued job work. Thus, the margins were affected in the early days of the project.

Inadequate working capital: The unit was not provided adequate working capital since its inception and against its requirement based on estimated operating cycle for the first phase of around Rs 900,000, it was eventually sanctioned working capital limit of Rs 300,000 only. This

resulted in low capacity utilisation and the company, in turn, incurred losses.

Changes in government policies: Promised Investment Subsidy was not disbursed to the unit. To bridge this gap the promoters brought in extra funds which could have been otherwise utilised to meet working capital requirements. Hence, a cash crunch was effectively ensured. Also, during the early years of project implementation the central government increased customs duty on the import of shoddy rags by 40 per cent and raised the LC margins to discourage imports. These developments had a detrimental effect on the profitability of the company.

SWOT Analysis: Performance and Potential Analysis— Non-financial Parameters

The unit manufactures shoddy yarn that is well accepted in the market. The yarn is used in the manufacture of blankets, tweeds and shawls. It sells the bulk of its production within the state. Recently, there has also been an increase in the selling price of shoddy yarn which could have a positive effect on the viability of the business. Due to rise in virgin wool prices, woollen goods made out of virgin wool are becoming costly and such products are getting beyond the reach of the common man. To meet the requirement of cheap woollen goods for the masses, shoddy yarn products are the only alternative. In view of this, the shoddy yarn industry has potential. Shoddy rags required for manufacturing shoddy yarn is abundantly available from developed countries. The import of shoddy rags today are allowed with marginal customs duty. The enterprise has not faced any problem in procuring the requisite shoddy rags. In summary, a SWOT is presented on the next page.

<i>Strengths</i>	<i>Weaknesses</i>
<ul style="list-style-type: none"> • Experience in shoddy yarn manufacture • Insulated from strong competitive pressure by virtue of import duty on finished products • Established marketing channels 	<ul style="list-style-type: none"> • Old plant and machinery • Too narrow product line • Dearth of financial resources • Outstanding (defaulted) interest burden is high • Inability to offer required margins for technology upgradation to remain product and cost competitive

<i>Opportunities</i>	<i>Threats</i>
<ul style="list-style-type: none"> • Ability to service additional customer groups to expand into new market/segments • Falling trade barriers in attractive foreign markets • Ability to grow rapidly because of strong increases in market demand 	<ul style="list-style-type: none"> • Rising demand of virgin woven material • Changing needs and tastes of consumers warranting new equipment and upgradation every few years. This may be difficult for a resource starved promoter to fund

The use of blankets, tweeds and shawls in the northern region of the country is significant because of climatic conditions of the region. However, changing trends in fashion and production requirements require new technology to be installed in the enterprise.

Viability for Revival

The following is an analysis to explore the possibility for a revival of the enterprise:

Capacity utilisation: If modernisation is implemented, the enterprise will be able to survive and pay back its obligations in a three-year period. However, the cost implications are an additional Rs 3.5 million.

Profitability: The profitability of the unit will improve if the proposed modernisation takes place. The enterprise can then earn sufficiently to pay up interest on its existing and proposed liabilities all within a period of three years. However, the promoters are too weak to offer necessary margins. In essence, the most critical element from the revitalisation point of view is the cash flow position and debt service potential of the enterprise.

Cash flow and the debt service coverage ratio: The cash flow position of the enterprise has been weak and the promoters do not have the margin to offer for enhanced working capital. The overall debt service coverage ratio will be two if modernisation takes place and the enterprise operates at 80 per cent capacity. But in the absence of enhanced working capital and term loan for upgradation, the outstandings (default) of the enterprise on interest will be killing. Hence, the enterprise cannot continue operating in the current mode. If the promoters are not in a position to bring in necessary margins, a one-time-settlement and exit option is the only way out!

Revitalisation Package—In a Hypothetical Scenario

A revitalisation package based on the assumption of modernisation of existing production process with necessary technology has the following costs and means of finance as given in Table 4.2.

The cost of the revitalisation plan includes the cost of fixed capital expenditure (on purchase of Japanese and German woollen cards worth Rs 3 million) and increase

Table 4.2: Revitalisation Package

(Rs in million)

<i>Cost of Project</i>	<i>Amount</i>	<i>Means of Finance</i>	<i>Amount</i>
Fixed capital expenditure	2.05	Term loan	1.33
Increase in working capital	1.65	Soft loan	1.09
Preliminary expenses	0.67	Promoter's contribution	1.95
Total	4.37		

in working capital requirements due to increase in the capacity utilisation of new plant at 80 per cent capacity of Rs 2 million. Term loan of 75 per cent of equipment cost and working capital of up to 75 per cent of additional requirement may be sourced from the State Financial Corporation (SFC) and banker respectively.

The revitalisation of enterprises in a sector will hardly be a standard package, as this case illustrates enterprise circumstances vary. Nevertheless, enterprises in a sector located along similar circumstances on the supply chain may confront similar problems and opportunities.

Case II: Exploring Broad Revitalising Requirements for Enterprises: Counselling along the Supply Chain

A counsellor working towards revitalisation of an industrial sector need consider the performance and potential analysis or SWOT of different segments and evolve separate action plans for each segment. Further, target

areas for intervention in a unit may be identified by an analysis of target enterprise or enterprises. Counsellors working on developmental projects may work on successfully exploring revitalisation package for an enterprise or groups of enterprises that may serve as a demonstration model for others to emulate. Consider the powerloom enterprises at Nagari in Andhra Pradesh, as an illustration. Nagari, in the Chittoor district of Andhra Pradesh is located about three hours away from Chennai. The main activity in this region is centered around production of cotton shirting, dress material, lungis, dhotis, duppatta and saris for export as well as for the domestic market. Most fabric are manufactured on powerlooms and supplied to garment exporters through agents and garment manufacturers at Chennai, Bangalore and Mumbai. Most looms are of a conventional type i.e., plain, dobby and jacquard. Nagari has about 15,000 looms. Sizable proportion say 20 per cent of this are, however, believed currently inactive. Most units are employing the manual wet processing method using vat, reactive and direct dyes. Raw material such as, cotton and silk yarn are procured from Tamil Nadu and Karnataka. This 'cluster' produces around 30 million m per annum of about Rs 1 billion. The master weavers operate on job-work basis. Not only yarn but also dyes and chemicals are supplied to job-working tiny weaving units who largely operate from households.

An analysis of a sample of representative under-performing enterprises with low capacity utilisation indicated the following problems:

- Problems in quality levels of raw material i.e., yarn, dyes and chemicals.
- Lack of upgradation and modernisation of looms.
- Inadequate maintenance of existing looms.
- Use of manual (hand) processing techniques affecting productivity and quality.

- Absence of scientific/professional quality management systems.
- Lack of awareness on accessing export markets directly.
- Absence of instruments for testing of quality parameters.
- Frequent power shutdown with high tariff rates.

The testing facility since established by the Textiles Committee (Ministry of Textiles) at Nagari resolves testing issues and the problem of access to ISO quality implementation systems related consultancy. The power issue has also been resolved by virtue of the 'industry' association having secured cottage industry status for powerloom manufacturers in the cluster. A diagnosis by the textiles committee facilitated these initiatives. But, what of other issues?

As part of the action plan to revitalise enterprises in the region, it may be necessary to offer testing facilities to check quality of raw material yarn and dyes from different sources including the directly sourced 'Ahmedabad' variety. Identifying ideal sources of supply is a critical requirement. Middlemen in the region are found to be eating into the margins of powerloom enterprises. Facilitating upgradation may be more feasible if pursued on a network basis given the necessary cost implications. A common facility centre (CFC) cabinet dyeing unit could help cluster actors evolve from the hand dyeing process. Further, other than a couple of larger exporters, 'master weavers' may be of relatively smaller size and may not go in for ISO quality systems in large numbers. The Textiles Committee also needs, to focus on developing 'local case studies' on benefit of quality consciousness and process and technology upgradation. An interactive fora with local bankers will help master weavers understand the perspective of bankers with regard to maintaining

statutory books of accounts and their presentation and scrutiny as part of appraisal for project financing. The technology upgradation fund (TUF) scheme of the ministry of textiles requires vigorous promotional and synergisation efforts. A CFC softening plant of about Rs 2.5 million may also be considered by encouraging networked action. Master weavers largely induce the entrepreneurial spirit in this cluster and hence they have to be targeted for interventions more than the household powerloom operators with three to four looms who supply to the master weavers.

An Elaborate Analysis of a Sample Enterprise Indicate Further Areas of Intervention

The promoter of XYZ Traders is a master weaver. He does not operate any looms but gets the fabric manufactured and processed on job-work basis. He, however, has his own dyeing (tub method) facility in terms of a gear boiler of investment of Rs 100,000. His turnover in 2000–01 has been Rs 10 million. The enterprise exports shirting and socks and supplies churidhar material to the domestic market through agents. The cost structure of the enterprise is presented in Table 4.3.

Further, adding about 1 per cent to costs for discounts/rejects. Net profit was only about Rs 200,000 per annum or 2 per cent on sales. The operating cycle of the enterprise in simple terms is as follows:

<i>Raw Material Purchase/Stock</i>	Stocking period is negligible as it is purchased locally as and when required
<i>Work in Process</i>	2 months
<i>Sundry Debtors (realisation)</i>	2 months

Table 4.3: Cost Structure Analytical Brief of XYZ Traders, Nagari (2001–02) (Rs in million)

Sr. No.	<i>Main Constituents of Annual Cost of Production</i>	Costs
1.	Raw material a) Yarn (from local traders procured on an average of two months credit with interest mark-up cost of total 3 per cent on 60 lakh of annual requirement) b) Chemicals and dyes	6.18 2.00
2.	Relevant labour charge	0.90
3.	Interest on bills (cheques) discounted by private sources (two months postdated cheques are invariably received. The same is immediately discounted @ total 5 per cent)	0.50
4.	Fixed expenses in terms of salary of management team	0.12
	Total cost	9.70

Working capital cycle of the enterprise is around four months. The promoter has not approached a bank for necessary limits though he is in a position to offer the required security and margins. He is not aware of the imperative, or the option or modality! Table 4.3 on the cost structure of the enterprise presented above indicates the following:

1. The enterprise is buying in uneconomic lot sizes (non-bulk purchase) and on credit purchase and is hence losing out on realisable profit margins. The enterprise is also discounting cheques by private sources for quick realisation and is thereby further losing out on margins.
2. A working capital facility of about Rs 3 million (one-third of the annual requirement of about

Rs 9 million) is required for operation of the business. The promoter has the resources to offer security/collateral to a bank as also necessary margin related resources. By going in for formal, adequate, working capital facility, he could save Rs 180,000 on credit purchase and about Rs 500,000 on discounting costs. Thus, gross benefit is Rs 680,000 while interest cost on formal working capital of Rs 3 million could be about Rs 360,000 per annum. That is, a net benefit of Rs 320,000. This effectively, more than doubles profit by reducing cost of credit purchase and cost of discounting bills.

3. An industrial counsellor could help to source dyes and chemicals inputs directly from Ahmedabad. They may be up to 15 per cent cheaper. This option could help the average enterprise in the sector to save about Rs 300,000 per annum (in this case) or, effectively, further increase margins as to increase profits by, in total, three times over! Industrial counsellors, therefore, play a critical role in networking with the lead bank in the region to facilitate disbursement of working capital upon preparation of past and projected financial statements by master weavers. Many well performing units suffer due to their ignorance about benefits of this option.

Successful Powerloom Enterprises Go in for Technology Upgradation—Learning from their Plans and Experiences

Yet another master weaver operates KRT Textiles with his three brothers. The enterprise has an annual turnover of about Rs 25 million. The enterprise operates at close to full capacity, that is, on double shift basis. The promoter now plans to benefit from increasing operational

leverage by enhancing the number of looms in his enterprise in terms of installing technologically upgraded autolooms. He already utilises 60 of his own looms in business. It is only orders in excess of own capacity that he outsources. Greater productivity of autolooms is encouraging him to go in for the TUF scheme at an implication of Rs 6 million including import duty of 9 per cent. The expenses of the enterprise (pre and 'likely' post) upgradation is presented in Table 4.4.

Table 4.4: Approximate Annual Expenses of KRT Textiles, Nagari (2001-02)

(Rs in million)

Sr. No.	Major Components of Expenses	Pre-upgradation	Post-upgradation
1.	Raw material—(50 per cent cash and 50 per cent credit @ 3 per cent for 2 months)	10.0	
2.	<ul style="list-style-type: none"> • Chemicals and dyes—5 million • Labour wages—3 million 	8.0	50 per cent fall in labour wages
3.	Washing and finishing (job work)	1.0	
4.	Power (with generator)	2.0	30 per cent fall in power charges
5.	<ul style="list-style-type: none"> • Interest cost (credit on raw material purchase @ 3 per cent on 5 million i.e., Rs 150,000) • Interest cost (Bills discounting of about 50 per cent of bills viz., Rs 12.5 million @ 5 per cent for two months or Rs 625,000) 	0.775	
	Total	21.77	

Higher price realisation and greater margins are also expected as better quality output will be produced and blended products will be manufactured. The operating cycle of the enterprise is four months. At a current turnover of Rs 25 million the enterprise requires about Rs 8 million of funds for 'rotation' purposes. The cost of this facility could be about Rs 1.2 million per annum @ 15 per cent on Rs 8 million (institutionally sourced). By going in for such a facility, the cost of credit purchase and bills discounting may be saved. By going in for technologically advanced autolooms, the enterprise would also save about 50 per cent on labour charges and about 30 per cent on power charges. In addition, margins and realisation per sq m is expected to be much higher in this case given better quality output and facility to deliver good quality blended products. Such aspects have to be quantified, documented and disseminated.

The main advantage of the job-contracted powerloom weaving operations in the region is believed to be the capacity to accept orders as low as 1,000 m of specific designs—A 'low volume customised market' segment exists as a niche for enterprises in the region. The utilisation of cheap fabric is an advantage in the price conscious market segment. But, more important are aspects such as delivery (in 45 days) to larger Indian subcontractors like Arvind Mills which distinguish this successful master weavers. He also has his own ETP for dyeing operations. While successful master weavers are progressively pursuing the options indicated above, poor performers are barely existing. The output of enterprises in the region is expected to have shrunk to half of that achieved a few years ago. To survive, cost and technology upgradation is an absolute must.

A Common Procurement and Financing Plan for Weavers at Nagari—An Introduction to Group (Networked) Action for Individual Benefit

A network of five weavers in the region produce about 1,800 m of fabric per day in a 12-hour shift. The selling price is about Rs 10 per m. This works out to a total sales realisation of Rs 18,000 per day for the network. Raw material cost works out to Rs 11,000, power cost about Rs 1,000, labour (piece rate) Rs 1,500 and oil and maintenance and miscellaneous expenses Rs 500. The enterprises operate with own funds as working capital. The net margins are accordingly estimated at Rs 4,000 per day. This is, in effect, a margin of about 17 per cent.

The five weavers, together, have 73 powerlooms on which they weave saree fabric. The group purchases raw material on credit from local traders at 10 per cent interest (mark-up on price) for three months. They have annual sales of Rs 18,000 per day (for 300 days) or about Rs 5.4 million per annum. Raw material cost is Rs 11,000 per day for a three month period working out to over Rs 800,000. By avoiding credit purchase and buying in cash the group may save on the cost of credit purchase and avail the benefit of bulk purchase, significantly improving margins. Institutional funds will have to be provided for things like, raw material purchase. Hence, a revitalisation package need often go beyond looking at mere enterprise specifics in isolation. Group action may be an imperative. It is, therefore, necessary to also look at the sector and other enterprises in tandem. In many circumstances, this may be the only viable option.

Chapter 5

Understanding Poor Performance and Revitalisation... a Gamut of Factors and 'Actors' for Intervention

The two cases presented in the previous chapter provide insights into the causes and symptoms for poor performance, and indicate the need to work with different 'actors' while evolving and implementing a revitalisation plan.

An enterprise must earn a surplus sufficient to repay maturing liabilities and provide for sufficient return on capital employed necessary for developing business. Whenever the generation of surplus is relatively low, performance and potential analysis and revival plans have to be evolved. Tackling underperformance and planning for revival calls for a study of symptoms and causes of underperformance. The case in the previous chapter presented indicative factors that may contribute to poor performance. This chapter elaborates in a more 'holistic' fashion.

Causes for Poor Performance

Contributors to poor performance (below potential) in terms of say, optimal capacity utilisation are often classified into management areas like production, marketing, finance, etc. These causes can also be classified on the basis of their nature as follows: *Managerial causes*: Lack of control systems [such as incorporating economic order quantity (EOQ) principles or 'cash cum cost' systems], frequent resort to costly 'informal' finance, etc.; *Strategic causes*: Poor response to growing international competition or non-diversification to new markets or products, etc.; *Structural deficiency*: Excessive formally or 'informally' sourced debt, poor equity base, excessive reliance on institutional support of 'dole', low cushion for prolonged cost based competition or recession, poor cash flow.

An important contributor to poor performance is a weak equity base. Institutional or informal finance may hardly be sufficient to accommodate a sudden rise in, for instance, input prices. Poor financial management in terms of an entrepreneur, not being aware of the dangerous implications of say purchasing fresh equipment from working funds given the resultant (likely) liquidity strain can lead to inability to meet outstanding obligations and/or poor performance. In this regard, it is necessary for a counsellor to understand that financial statements submitted by an entrepreneur may not always be 'realistic'. Hence, relevant analysis need rely more on 'actual data' as secured from entrepreneurs. A small enterprise may experience increasing profits and/or margins, current ratio over one and have a debt equity ratio that is satisfactory. However, it may still be performing below potential due to poor structuring of costs and capital. This may further lead to cash losses, falling current ratio, debt-equity ratio and net worth. Hence, revitalisation is required not only

in enterprises which default in dues or confront a decline in profits. Underperformance may exist regardless! This, in turn may affect sustainability of an enterprise.

Increased cash generation of adequate amounts is an important indicator of health of a unit. Drop in internal cash generation occurs due to various reasons: Mismanagement in terms of dissension among partners, lack of adequate systems in business and, diversion of business funds for personal expenditure. Similarly, marketing problems may arise out of the following reasons: Detrimental cost based competition in the industry not being targeted by efficient marketing modes; inadequate product base; recession in markets; and, inadequate costing and pricing modes. Improper financial planning may be due to: Diversion of working capital for acquisition of fixed assets; slow (or non-recovery) of dues; unplanned capital expenditure like, only pursuing job work upon securing a large term loan for equipment and assets; and, resorting to costly 'informal' borrowings. Production problems may develop because of poor cost structure of an enterprise; lack of production planning and control (like balancing of equipment, for instance); and, improper inventory planning leading to imbalance/stagnancy in stock holdings.

The External factors to be considered are: Cost based than innovation based competition in industry; high raw material costs; threat of substitute products; and market saturation in relative terms with increasing number of startups. Consider the case of the co-operative societies at Kannur, Kerala. 'Societies' have been, in recent years, serving as 'classical' cases of underperformers across different industrial sectors. They suffer from most of the internal and external factors indicated in this section.

As an illustration, co-operative societies in the handloom sector in Kannur target the domestic market given the stringent quality and standardisation requirements of international markets. They, invariably survive on the 13 per cent odd rebate that they secure from the

Factors contributing to the poor performance of an enterprise may be managerial, strategic or structural. A small enterprise may display good satisfactory indices in terms of management ratios. Nevertheless, a disoptimal cost and capital structure may affect sustainability. The factors affecting performance may be internal to an enterprise or external.

state government upon sale of their products. Products of such enterprises as also smaller societies are sold over fairs and to meet intra-state demand during the festivals of Vishu, Onam and Christmas—*a seasonal (and effectively subsidised) demand even in the domestic market*. The smaller societies with about 20 looms each (in operation) produce about eight m per loom per eight-hour shift per day. Considering this capacity installed, the enterprises may produce about 2,400 m per year of 300 days per loom. This implies production of 48,000 m which could be sold @ about Rs 40/m or at about Rs 1.92 million per annum.

However, most societies are operating at far less capacity of an annual turnover of Rs 700,000 to 800,000. These poor performing societies largely produce dhoti type products or veshtis and have a negligible product mix. They pursue no attempts on innovative design or new product development. Yet another critical cause for poor performance is cost uncompetitiveness vis-à-vis competitors. Their cost estimates indicate that for every metre they produce, they could realise at best Rs 40. In fact, veshtis from handloom enterprises in Tamil Nadu are available in the market at Rs 33 each. Their costing on a per metre basis is as follows: Rs 14 as labour charge, Rs 16 raw material (yarn) charge/m, Rs 5 per m for chemicals and dyes and winding and other charges @ Rs 10/m. This works out to Rs 45, while sale value may be only a maximum of about

Rs 40. A government rebate of 20 per cent helps yield a net margin of a maximum 10 per cent. However, government rebates are becoming progressively difficult to get. Moreover, an excessive dependence on external support could contribute to unviability of such enterprises. Societies need be counselled to improve the scope for sustainability. Also, many 'members' often breakaway from such societies and cater directly and independently to merchant exporters on job work basis and price their services not at Rs 14 as do societies but at Rs 8 per m. This in turn further affects the viability of societies. Control of 'wages' to members as also productivity has to, both, be targeted.

Further, the co-operatives are believed to procure raw material yarn and chemicals from National Handloom Development Corporation (NHDC) at 5 per cent cheaper than market rates. But this is far too little to contribute to sustained viability. In fact, at times, it is believed that NHDC rates are less competitive compared to market rates! The option for such a 'representative' society that owes (in terms of default) the National Bank for Agriculture and Rural Development (NABARD)/banks about Rs 1 to 2 million is to also vigorously pursue networking options and reach out to markets across the country. The marketing front has to be targeted along with 'wages' to members, as also labour productivity.

Networking with the DC (Handlooms), Federation of Indian Chambers of Commerce and Industry (FICCI), and participating in the dozens of domestic fairs organised by them in India could help directly reach out to new consumers and appoint distributors and facilitate tie-ups with traders elsewhere in India. Networking with the National Small Industries Corporation (NSIC) could help realise government and public sector orders and supply contracts. However, a concomitant option is diversification to other product lines such as curtains and upholstery.

In summary, participation in various domestic fairs, appropriate investment in sample preparation,

development of a wide range product mixes, investing in design development seeking consultancy support from design institution such as the National Institute of Design/ National Institute of Fashion Technology etc., are all initiatives whereby business risk may be spread by working as networks. Volumes buyers could also be accessed. Progressively, and necessarily, such societies could move towards export markets and pursue necessary upgradation. Networks of societies to establish costly common facility centres (CFCs) may also be promoted. A CFC for ‘cabinet dyeing’ could cost about Rs 12 million. Such a CFC could facilitate (per) society cost reduction on relevant process by up to 25 per cent. An industrial counsellor has to also learn from the experiences of successful peers to catalyse implementation of these requirements. Consider the circumstance of a benchmarked ‘role model’ society KRSB as an illustration.

A Benchmarked ‘Role Model’ Society for Other Peers to Learn From

The labour costs of this ‘role model’ society is lower than that of even a well established and integrated private limited company, that is, an exporter operating in the sector. Both enterprises have a similar level of activity.

Table 5.1: Cost Difference—Enterprises at Kannur

<i>Annual Costs (2001–02) of an Integrated Exporter Operating with Own Looms (1)</i>		<i>Annual Costs (2001–02) of the Model Co-operative (2)</i>	
<i>Element</i>	<i>Amount</i>	<i>Element</i>	<i>Amount</i>
Wages and benefits	23 million	Wages and benefits	17 million

The Table 5.1 indicates that the labour cost of the integrated (not job working) exporter (1) is adverse vis-à-vis model co-operative (2). This is due to the fact that better worker 'monitoring' in the co-operative has actually enhanced labour productivity up to 12 m per loom (per labour) per shift. The integrated exporter has a labour productivity of only about eight m per shift per day per loom. Labour in both cases are paid a fixed daily wage rate. The 'model' co-operative society above is one of the few societies faring well. Workers in other societies in the region may have the motivation, but management does not seem to have the dynamism or exposure to directly access markets or efficiently manage operations. Both enterprises do not even consider the domestic state market. They focus on the quality conscious export and domestic 'metropolitan' city market. Higher prices are realised up to even Rs 46 per m. The model society is, in fact, progressing towards ISO 9000 certification—perhaps the only enterprise of such constitution in the country to do so! The dynamic management of this society participates in national and international fairs. New product and design development has also received sustained thrust. They do not even make the conventional veshtis. Many societies and enterprises in the region largely survive on the basis of government support, as has been the case of the protected market economy and the license raj of yesteryears!

The role model society which has a turnover of over Rs 40 million with 20 per cent net margin on sales is going in for cabinet dyeing from the current practice of open bath dyeing. Cost reduction of up to 20 per cent on this front is expected by this initiative. Hence, there is scope for the potential networked action plan for enterprises and other smaller underperforming and low capacity utilising societies to establish CFC dyeing units. One (average) enterprise in isolation may not have the volume of assured business to operate such a facility (independently), today! Evolution of such options is possible by

benchmarking studies. Nevertheless, enterprise analysis in studying causes for underperformance remain critical.

Symptoms of Underperformance

The predictive symptoms of underperformance on the marketing, production and financial front may include: *Marketing*: Decreasing or relatively static sales turnover or, irregular and highly fluctuating activity levels; *Production*: Low capacity utilisation; high work in process and finished goods stock, or under utilisation of fixed assets. *Financial Management—Liquidity*: Increasing sundry creditors; non-payment of statutory dues/committed fixed expenses or, decreasing current ratio; *Profitability*: Decreasing or poor contribution to sales ratio; high fixed costs; improper product costing/pricing systems or, inability to identify profit/loss/contribution productwise; *Control Systems*: Lack of realistic financial records/projected cash budgets/ financial statements; lack of details of age-wise break up of present sundry debtors and improper receivables collection machinery or, changing pattern of cash to credit sales.

Revitalisation—Formulation of the Plan Involving an Array of ‘Actors’

The formulation of a revitalisation plan involves: Conducting a performance analysis to understand causes of underperformance, and, deciding the plan to be adopted to reduce weakness or its adverse impact on a unit’s operations and, the means for revitalisation as to ensure sustainable development of competitive advantage in an enterprise.

The revitalisation plan facilitated by an industrial counsellor may necessarily involve interventions amongst other 'actors' involved with a small enterprise. These other 'actors' may include:

Related enterprises: These include raw material suppliers, customers and other supporting enterprises. The component suppliers offering shoelaces and soles to the shoe manufacturers in Kolkata are an illustration of the shoe manufacturers' related enterprise.

Private and public business development service providers: The actors in this category include centres of technology such as the testing and (largely) quality control laboratories like CIPET. They may also be for non-profit entities such as non-governmental organisations or industry associations. They may be profit oriented ones like firms of Chartered Accountants and C & F agencies. Some like the Council for Leather Exports, for instance, possess sectoral specialisation. Some like the Small Industries Service Institutes (SISIs) operating under the aegis of the central government offer training and technical service but possess transversal specialisation. The latter offers subsidised services for small industry. An industrial counsellor may himself represent a segment in this category. However, he may hardly be a 'master of all trades'. Synergising specialised PPBDS, therefore, remains critical.

Centres of higher education and research: The actors in this category include academic institutes. The Indian Institutes of Technology located across the country are an example. So are various management institutions. The coir product enterprises at Alleppey, for instance, have the Central Coir Research Institute to offer technical support. They could serve as catalysts in the development process by means of ability to offer skill development and research inputs. Some institutions such as the National Institute of Design also offer support in product design to enterprises across the country.

Entrepreneur associations: Associations represent and also help to reach out to small enterprises on issues related to other actors. Associations may consider establishing a sub-contracting exchange, which is supported by Development Commissioner Small Scale Industries DC (SSI), for instance, to facilitate linkages between demanding and supplying enterprises.

Larger enterprises: Larger enterprises, by working with smaller enterprises in terms of backward linkages reduce their own fixed investment and inventory costs. They may also increase their response flexibility to market changes in demand and, reduce their costs and overheads. The coir clusters in Alleppey and brassware cluster in Moradabad are vertically deep. The larger exporters are linked to various manufacturing units down the supply chain. They in turn offer a market for smaller 'exporters' and manufacturers.

Financial institutions and banks: These actors constitute developmental banks like SIDBI, NABARD, financial intermediaries, and state level financial corporations. Nationalised commercial banks and private commercial banks also comprise this actor. Their existence is closely linked to industry and they may offer customised assistance to meet industry requirements if roles are effectively synergised. Evolving new financial instruments that could serve, as a win-win mode for such institutions as well as for small enterprises in different sectors is an intervention that may be pursued by an industrial counsellor.

Non-governmental organisations (NGOs): The actors in this category include organisations functioning without profit motive such as NGOs. Their 'neutral' orientation and their access to international resources lend them credibility. State level, National Entrepreneurship Development Institutions and NGOs offer training and support services for tiny and small enterprises. Some of them have effective market linkages abroad, which could also facilitate market-led growth of networked tiny and small manufacturers.

The government: Within the government there are bodies that function for the development of smaller enterprises. The ministry of small scale industries and also that of agro and rural industries play an important role in formulating policies and co-ordinating activities of institutions in different regions. The ministry of agro and rural enterprises and the development commissioner (small scale industry) have the capacity to formulate and implement legislative reforms to facilitate growth of the small scale industry (SSI) sector. The subcontracting exchange schemata implemented through industry associations is funded by the DC (SSI). The ministry of food processing industries canalises subsidy and incentives for enterprises in the sector while the ministry of textiles supports research and development institutions like the Ahmedabad Textiles Research Industry Association and, service providers and inspection agencies such as the textile committee. A counsellor may have to also intervene with this actor as to benefit small enterprises.

While broadly categorising causes for underperformance, it is necessary to understand symptoms of weakness as to pursue preemptive measures. The measures are not to be explored in isolation of other 'actors' related to an enterprise. Invariably, roles of these other actors such as related enterprises, private and public service providers, centres of research, NGOs, the government, etc., may have to be synergised to facilitate sustainable revitalisation.

An Illustration on the 'Synergising' Role of a Counsellor

The roles of different actors who have to be involved in a revitalisation plan have to be nevertheless

synergised. The profile of actors whose roles may be effectively canalised for revitalisation of enterprises may vary from sector to sector and on the basis of locational circumstance. In the case of enterprises in the powerloom sector at Sholapur, Maharashtra, for instance, various problems are evident. There is a dearth of awareness about emerging technology, management systems and market related information. There is also dormancy with regard to identifying value-added products. Enterprises stick to 'terry towel' manufacture. Gaps in processing and weaving technology are also evident. These are just some of the issues. Who are the actors whose roles need be synergised for sustainably developing enterprises in the region? The implications of the World Trade Organisation (WTO) on the Indian textile industry will have to be understood. The services of the Indian Institute of Foreign Trade (IIFT) could be availed of for this purpose. Information on and direct access to international markets may be facilitated by the Powerloom Development and Export Promotion Council. Quality systems may be incorporated in operations by availing the services of the Textiles Committee for ISO implementation. They are ideal in comparison to other general systems. Lead assessors, as also their personnel are also qualified in the area of textile technology. Technology upgradation, identifying cost effective solutions for treatment of water and effluents, and optimal weaving technologies may be facilitated by availing the services of the Textile Commissioners office and the Bombay Textile Research Association (BTRA). Exposure to better weaving/processing processes and scope for alternate products may be identified by means of visits to more developed enterprises in other regions. This last, may include successful enterprises in Tirupur or Ludhiana, where agencies such as the United Nations Industrial Development Organisation (UNIDO), Cluster Development Programme have also intervened. Better inventory management, understanding the cost benefits of upgrading

to modern automatic and shuttleless looms may be facilitated by again availing the services of the textiles committee. Identifying value-added products in the form of made-ups (that is, product led diversification) may be facilitated by availing the services of the National Institute of Fashion Technology (NIFT). A raw material bank or common purchase consortium can be implemented as a cost reduction initiative by synergising the activity of the National Small Industries Corporation (NSIC) with enterprises in the region. The NSIC also offers collateral free financing by virtue of stocking commonly purchased material in their own warehouse. A warehouse may be perhaps established in Sholapur with funding support from the infrastructure development schemes of the DCSSI or the ministry of textiles. All these options presented above are merely illustrations on the scope for involving various support institutions and private and public service providers while working on the revitalisation of an enterprise.

Chapter 6

Business Development: Assessment of Performance and Strategising Potential

What is Sustainable Business Development?

Sustainable development for a small enterprise could mean sustainable decrease in costs or increase in profit margins. In essence, it implies development of a sustainable competitive advantage. The mandate for the industrial counsellor is to upgrade business operations of an enterprise. Revitalisation of small enterprises in order to successfully face international competition requires professional expertise and 'missionary' zeal on the part of the counsellor.

The development of an enterprise may involve: increase in profitability orientation by taking better advantage of leveraging options (formal finance or fixed-cost orientation); expansion or diversification; entering new markets or developing new value-added products to

reduce business risk; utilising better management information systems in business; and use of better technology/improved equipment. Irrespective of the mode of development, the outcome may be measured in terms of increased output, increased margins or reduction in variability in the margins of an enterprise.

Product and Market-led Options to Business Development

Business development may involve a plan by an enterprise to sell more of the same product to the same customer segment or to different customers in geographic or segment terms. Consider the case of an entrepreneur involved in making reactive dyes in Ahmedabad. He may initially be a domestic trader, then become an exporter before graduating to direct sales to importers abroad—a market-led route to development. Product-led development may also occur in terms of product extension for instance to wall hangings from doormats and mattings offered to the same customer/consumer segment by coir product entrepreneurs in Alleppey. Enterprises may also focus on completely new markets and products—manure from coir pith targeting the floriculture segment in western Europe. These enterprises may diversify away from the home furnishing products manufactured for global chain stores.

Factors Influencing Development

Several factors affect the ways in which a business develops. These may be divided into external and internal factors.

External factors include changes in consumer preference from full coir to latex-backed coir mats and mattings, for instance. Other examples include Chinese and Philippine product manufacturers in brassware taking over the global market because of their cost advantage and the recession in international markets affecting demand for hand-made eco-labelled paper from Jaipur. The switchover to Generally Accepted Accounting Principles (GAAP) and banking reforms with regard to Non-Performing Asset (NPA) categorisation and lending norms affecting availability and implicit cost of institutional finance/capital to small entrepreneurs are other illustrations. Internal factors include the skills of an entrepreneur and his management team in efficiently managing a business in different functional areas. The utilisation of appropriate information systems in decision-making is another factor. Other determining factors include performance of an enterprise in liquidity management, inventory handling and effective formulation of marketing strategy.

The development of an enterprise is determined by all these factors. Before preparing a revitalisation plan, it is necessary for a counsellor to identify factors critical for business performance and development, and assess the impact of each factor on business. The evaluation needs to be made about performance and the potential of an enterprise to pursue plans to develop and revitalise internal circumstance and factors given external opportunities and threats.

In essence, a revitalisation plan developed by a business counsellor (along) with an entrepreneur could involve studying the performance of a business efficiently; analysing potential for the business and formulating revitalisation plans to ensure sustainable development.

Revitalisation seeks to evolve a plan to facilitate sustainable business development. The latter warrants upgradation of operations to develop a sustainable competitive advantage. Both external and factors internal to an enterprise need to be evaluated as also the performance and potential of an enterprise to pursue a programme to develop and revitalise internal circumstance and factors given external opportunities and threats.

Studying Performance of a Business

A counsellor has to go beyond turnover and 'margin' figures to understand the performance of a business. The scenario in the marketing, production and financial arenas needs to be scrutinised.

Analysing Performance from the Marketing Front

Analysing performance of a business from the marketing angle involves exploring customer and consumer requirements. For instance, consider small enterprises in the brass metalware cluster in Moradabad. The Chinese offer similar products at a fraction of their prices. It is necessary to explore how they do it and what their clients, both customers and consumers, require. Their customers or the middleman in the trade may stress on cash discounts and credit for their purchase while the consumer may lay stress on hand-crafted products and customisation in terms of design. A marketing programme that satisfies both client groups may then be developed after further analysis. How do the Chinese offer their products so cheap? Why are their raw material purchase costs so low? How can small enterprises in Moradabad reduce their costs? Would installation of expensive pressurised die casting machines in Moradabad help reduce costs by

reducing the labour component? Do customers want lower costs? In the coir product industry which faces intense competition from rubber or jute-based products, could a South India Textile Research Association (SITRA) based R&D initiative to upgrade spinning technology to substantially reduce cost of yarn supplied to manufacturers help meet cost-based competition from rubber and jute products? The customers' or exporters' requirements, which reflects requirements of small and large importers abroad, may be for low volume customised products. In this case, the high degree of vertical depth in terms of small enterprises in the coir cluster at Alleppey may be ideal to meet this need rather than an enterprise with a large integrated manufacturing base. Hence, analysis of the marketing area may offer insights into orienting the production front. This merely underlines the need for an integrated approach by business counsellors.

When a counsellor explores the performance of a business from the marketing perspective, both customer and consumer requirements need to be studied. Would small exporters of leather products be in a position to effectively deliver the volumes demanded by global chain stores? Are they weak in terms of organising themselves into a united subcontracting base to cater to large volume buyers? Changing demand and market segmentation, pricing, promotion and placement modes need to be scrutinised. Some customers who are strapped for cash may require credit facilities from manufacturers while others will try to negotiate a higher discount or lower price. The utilisation of market segmentation tools with respect to consumers based on income stratification may help hand block printed textile manufacturers and exporters in Rajasthan and Gujarat to price and promote their products. In developed countries, consumers may require hand-crafted socio-eco labelled products to match current trends in fashion in terms of design, texture and colour combinations. Brand consciousness may also exist. However, in the East

European or African markets, consumers may be more cost conscious while making similar purchase decisions. Other aspects may be accorded secondary importance. A competitor is one catering to the same market segment. It is also necessary to understand competitors strengths vis-à-vis a small enterprise. For example, very small manufacturers may not be in a position to seek cash discounts for bulk orders from traders or extend credit facilities as large competitors do. This is mainly due to the fact that they may operate on the basis of suppliers' credit and may not have access to institutional working capital. If they try to tap the Mutual Credit Guarantee Fund (MCGF) scheme for working capital which is supported by United Nations Industrial Development Organisation (UNIDO), Small Industries Development Bank of India (SIDBI) and State Bank of India (SBI), this issue may be resolved. Technology changes and emergence of substitute products also need to be considered. It is common to see coir product manufacturers broaden their product base to jute or polypropylene-based products to meet market demand. This is just one part of the transformation and evolution of an enterprise from full coir to other product mixes.

Trends in industry-related policies and social changes need to be evaluated by a counsellor. Preference for 'natural' products over synthetic ones and increasing concern towards biodegradability are leading to changes in consumption patterns. Consumers abroad prefer products packed in biodegradable or re-cyclable 'environment friendly' material than in plastic-based material. This indicates the need for plastic product manufacturers to focus more on 'industrial' rather than consumer products. An understanding of the trend or direction of changes in such factors is warranted. This serves as a case for extensive policy and environment analysis as part of the study of the marketing function.

Market planning after performance analysis involves decisions on aspects such as pricing. The market

plan may include a strategem to avoid middlemen. The agents in the brass parts cluster in Moradabad, who are involved in securing orders from large exporters and ensuring effective manufacturing (related sourcing) from numerous small manufacturers, may however, play an effective role in terms of providing finance for operations of very small and tiny manufacturers. A market plan to avoid agents and deal directly with exporters may lead to their not being able to meet delivery or quality standards given the resource crunch of small manufacturers. A counsellor needs to probe such aspects in depth. With regard to promotion and placement, for instance, it is necessary to analyse measures taken to promote the business. How do discount and credit terms offered to customers compare with that of competitors? Can changes be incorporated in the enterprises' pricing and marketing strategy? What could be done to make the customers more effective? Do other channels exist? An analysis of such aspects could help effectively formulate a market plan.

Evaluating the Business from the Production Angle

On the production front, the areas of scrutiny include optimal utilisation of labour and equipment, quality standards, inventory management on the material-stocking front, and 'line misbalancing' in terms of capacity of equipment. Are there checks on the quality of finished goods and raw materials? Due to non-utilisation of systems tools, an enterprise may be incurring losses in carrying inventory. This problem is very serious as significant costs in the cost of the final product are raw material costs in most traditional sector-based enterprises. Introduction of EOQ tools of inventory management along with a stores ledger for recording issue/receipt of material could control excess inventory and reduce the cost of working capital.

Evaluating Performance on the Financial and Systems Front

Cash and margin problems as also system-related issues also need to be studied. These may cover aspects such as excess investment in stock; poor formal working capital facility leading to resort to costly informal finance; using relatively costly working capital to create non-productive assets or to create fixed assets; inadequate margins due to improper costing and pricing and improper cost structure orientation leading to the same; and improper inventory or credit sale management precipitating margin problems.

Some key questions need to be raised when exploring areas with regard to systems: Are there systems to define the ideal cost structure? Does the entrepreneur give due consideration to opportunity cost of his own locked-up funds? Are there records of inventory and dues? How are purchase and sales decisions made in terms of discount/credit?

While evaluating a business in terms of marketing, both customer and consumer dynamics have to be studied in detail. Product requirements of 'buyers' and 'users' determine production strategy such as the size of an enterprise. A market plan involves analysis of the pricing, promotion and placement front too vis-à-vis middlemen and competitors.

The case of the coir sector enterprises along the supply chain elaborated below serves as an illustration of such an evaluation.

Evaluating the Performance of Enterprises Related to the Golden Fibre

A SWOT analysis of the coir-based enterprises in the Alleppey region of Kerala provides an example of an evaluation of the internal factors that may be classified into strengths, weaknesses, opportunities and threats which essentially comprise external factors. The circumstances of the enterprises in the region will, however, broadly vary depending on whether the enterprise is a resource-rich exporting enterprise or a resource-poor manufacturer. These are the two major enterprise segments in the region. Strengths on the financial front of exporters include their financial resources and the presence of bankers and developmental financial institutions in the region. Proximity to the Coir Board headquarters facilitates access to institutional funding support, canalisation of subsidies for market development, trade fair participation and so on. On the marketing side, their established linkages with importers abroad and relative dearth of competition from other countries given the 'virtual' monopoly on coir-based natural fibre resources are strengths. On the production front, the access to skilled labour and proximity to subcontractors or product manufacturers specialised in making different coir products constitutes a strength. The major weakness on the marketing front is the fact that enterprises compete with each other on the basis of price rather than innovation and differentiation-based competition. Similarly, cost-based competition from cheaper substitute products like jute, sisal, china glass and polypropylene is another problem area. Another weakness on the market front is an excessive focus on traditional market segments such as furnishing importers and chain and speciality stores than on the local industry and restaurant segment, for example. The

major weakness on the production front is the absence of adequate production and other efficient inventory management and Management Information Systems (MIS) in business.

With regard to the relatively resource-poor product manufacturers, the major strength is on the production front in terms of skills and established linkages with exporters in the region. The major weaknesses lies in terms of difficulty in access of institutional finance. They invariably find it hard to offer the necessary collateral and margins or necessary business records to avail of support.

Given the strength and weaknesses of the exporters in the region, the opportunities on the production front include investing in own looms, that is, backward integration in order to benefit from the relevant leverage. Therefore, there is scope for profitability, technology upgradation and establishing common facility centres. Further, the scope for reducing purchase costs by means of bulk purchase on consortium or networked basis is evident.

Strategy in Small Business: Essential Concepts

There are certain essential concepts that require elaboration to facilitate the mission of a counsellor. Customers buy goods from manufacturers to sell to users or consumers. Customers do not necessarily use the products themselves. Wholesalers and traders buy metalware products from small enterprises in Varanasi in bulk and sell them to retailers. Exporters buy similar products and sell them outside the country to chain stores and retailers. Chain stores and retailers are also customers and, in turn, sell to users or consumers. This distinction is critical to the formulation of a revitalisation plan. As specified earlier, a customer's needs may vary from consumer's needs. A customer invariably looks for the best deal in terms of

discount or credit. A high discount may be offered on products where margins or 'contribution' are the highest. This may encourage sale and thus manufacture of such products without affecting profits. Marketing, in fact, commences even before business identification and often involves all areas of management. Selling is a matter of ensuring and increasing sale of a given product. Selling incentives targeting consumers include:

- Reduced price or discount for a unit of the product.
- Offering several products for the price of one.
- Offering coupons for discount on repeat purchase within a timeframe to enhance usage rate of a product by clients.
- Offering better credit terms.

A small retailer may, for instance, adopt any selling incentive. The following illustration represents a caselet on an incentive option. Take the example of an entrepreneur, who makes and sells about Rs 400,000 worth of screen-printed textiles in Jaipur every year. He offers 30 days' credit to his customers. Earlier, his selling strategy was restricted to 30 days credit to regular customers. He secured an extra order for Rs 400,000 from a trader this year. However, after he made the products, the trader backed out. The entrepreneur is now considering a new selling incentive to dispose of the additional production. He has devised a new promotion and selling option. To new clients—both exporters and wholesalers—he plans to offer a 3 per cent discount if payment is made in cash within 10 days of delivery and 90 days' credit otherwise. He believes this will help him sell his excess stock of finished goods. What are the costs and benefits of such a strategy? Assume that 50 per cent of the increase in sales will include those availing discount and 50 per cent of the increase in

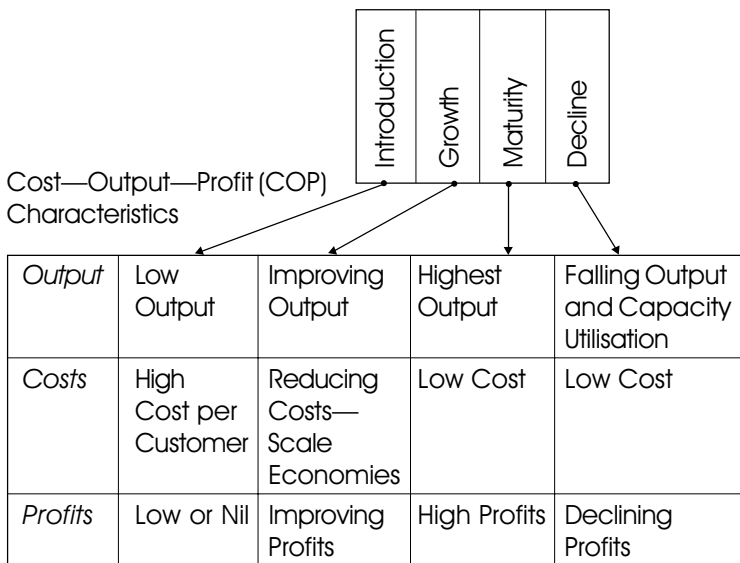
sales will include those availing 90 days' credit. The cost of production of increased sales may be assumed to be 70 per cent of increased sales. The real cost of locked up funds in credit sale is 3 per cent per month. This is the rate charged for credit purchase of raw material by informal moneylenders that he often approaches. The entrepreneur does not have access to formal bank finance. Therefore, the new likely total sales is equal to Rs 800,000. The cost of discount on additional sale is equal to Rs 6,000 (Rs 200,000 of sales @ 3 per cent). The cost of credit on additional sale for three months is equal to Rs 18,000 (Rs 200,000 @ 9 per cent for three months). Total cost therefore equals Rs 24,000. The increase in cost of production is equal to Rs 280,000 (70 per cent of Rs 400,000). Profit on increased production and sale is equal to Rs 120,000. The cost of proposed promotional terms equals Rs 24,000; Net profit amounts to Rs 96,000. Therefore, the increase in profit is Rs 96,000. The proposed promotional strategem could benefit the enterprise. A counsellor may help similarly analyse the cost-benefit of such strategem for small enterprises.

Strategies and revitalisation plans for an enterprise may focus on building a competitive or a marketing advantage. This may imply developing a sustainable cost advantage which will help an enterprise offer lower prices vis-à-vis competitors. Cost savings can also be used in other promotion methods such as offering better credit terms to clients. A differentiation advantage focused strategy offers buyers greater value than competitors. Often, a differentiation advantage stems from product features, service, quality or other attributes valued by customers. These are examples of real differentiation. Notional differentiation—one in the mind of consumers—may be created by a brand image and trademark. If entrepreneurs based in Sivakasi (matchboxes and printing) or Tirupur (cotton hosiery) can ride on a global image associated to their cluster, there is no reason why enterprises in other

regions cannot network to reap similar advantages. A niche market segment advantage, as in the case of customers seeking customised made-to-order products in small volumes, is also a viable option. A business that has none of these three competitive or marketing advantages and does not try to develop at least any one of them is sure to lose out to competitors.

Developing a Marketing Strategy

Every product has a life cycle. There is an introduction phase followed by growth, maturity and, decline phases. The schema below highlights the conventional characteristics and promotion strategy that may be adopted in each stage.



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Strategies

Sales Promotion	Heavy Promotion to Induce Purchase	Reduced Initiatives	Increase Given Competition	Discount or Credit May be Only Major Modes
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Coir mats and mattings, for instance, are in the maturity stage and heading towards the declining stage of its life cycle. The characteristics at this stage are declining sales, low cost per customer, and declining profits for manufacturers. At this stage, price is a critical competitive tool. Sales promotion in terms of various selling incentives other than discounts and credit may not necessarily yield much benefit. Substitutes for coir fibre products made from rubber, jute and sisal are available in the market place.

The marketing strategy to be employed at this stage could lay emphasis on developing a new life cycle for the 'product'. A new life cycle for coir-based products could be developed by trying to develop new uses for the same products and explore scope for value-added products such as geotextiles, manure from coir pith, scoring pads, corrugated sheets; trying to increase the number of users by creating new market segments in some markets or new geographical markets; trying to increase the usage rate of the products or frequency of buying or use of products by virtue of constant design development and innovation.

Product-led diversification, market-led diversification, and design and product innovation are the key to developing a new life cycle for enterprises in most traditional sectors of the Indian economy. Till such a stage is reached, the criticality of credit and discount strategies as essential marketing tools may remain paramount.

Developing a Strategy for Managing Cash

A cash crisis usually leads to underperformance and the failure of small enterprises. It is, therefore, necessary for a counsellor to study the management of working capital. Investments in current assets constitute a significant proportion of the total investment in most small enterprises. The quantum and percentage (in terms of total assets) of current assets in some 'better' performing small manufacturing units are as follows:

(Rupees in million in the year 2001-02)

<i>Enterprise</i>	<i>Inventories</i>	<i>Sundry Debtors</i>	<i>Cash</i>	<i>Total Current Assets</i>	<i>Percentage of Total Assets</i>
Woollen hosiery unit in Ludhiana	7 (35%)	5 (25%)	8 (40%)	20	70%
Powerloom unit in Ahmedabad	0.20 (4%)	0.30 (6%)	4.5 (90%)	5	55%

As evident from the tabulation, the quantum varies between enterprises and sectors, for instance. Working capital management largely involves management and control of current assets and current liabilities. It focuses on cash flows within the operating cycle of an enterprise. There are two concepts of working capital, viz.,: (i) Gross working capital which includes total current assets; and (ii) Net working capital which is current assets less current liabilities. The main items that comprise current assets in the context of a small enterprise are cash: in hand and in the bank; inventories comprising raw materials and

consumable stores; work-in-process; finished goods; and sundry debtors (or bills receivable or accounts receivables). All the items are included in the operating cycle. Items comprising current liabilities largely include sundry creditors (also known as bills or accounts payable) and trade advances (received by the company for supply of goods).

Working capital management mainly pertains to the management of current assets. It also nevertheless involves management of current liabilities. Analysing the requirements of working capital in a small enterprise warrants an analysis of the sector-market typology and production plan, and on the customer and input-supply circumstance:

- (i) Sector-market typology and production plan: The amount of working capital required is critically related to the business typology and the operating cycle. For example, in a restaurant, the requirement may be very low as the operating cycle may be hardly for one or two days. However, in an export-oriented knitwear unit, the cycle may be high—depending on raw material stocking (largely imported) and on payment terms.

In an enterprise functioning in a sellers' market, the working capital requirement may be much less as the operating cycle will be much shorter, mainly due to the fact that most sales will be on cash basis. As against this, a plastic pen manufacturing (and domestic trading enterprise) may have a much longer operating cycle as it could be selling mostly on credit and consequently would require a much higher level of working capital. Many entrepreneurs may find it a better financial decision to keep manufacturing goods even in the 'off-season' in domestic

market-oriented rubber mat making enterprises so as to keep on working above the break-even point (BEP), to meet at least fixed costs, on a continuous basis. Units manufacturing items like rubber doormats (for the domestic market) would have stable and uniform sales round the year. For such enterprises, working capital requirements may be almost the same throughout the year.

- (ii) Customer and input-supply circumstance: A trader in the domestic (Indian) market may have to keep sufficient quantities of finished goods as stock so as to be able to quickly supply them to retailers and, thus, beat competitors. Also, an enterprise may have to offer liberalised credit terms, therefore, increasing working capital requirements. If the supply of the material is seasonal, enterprises may have to store sufficiently large stocks of materials during season, at cheap rates.

The strategy with regard to discount or credit will have to be synergised with regard to the above circumstance of an enterprise. A counsellor will have a critical role to play herein upon evaluating the operating cycle over a period of time. A counsellor will have to understand that the working capital margin is often estimated with reference to the year in which an enterprise breaks even or makes a profit. Data on the following is required: expected capacity utilisation during the break-even level of operation; output, quantity and price of raw material required to produce output; and the quantity of raw material that the enterprise must carry in the break-even year of production. It is necessary to estimate the value of raw material which the enterprise will keep in stock. This is a product of raw material quantity and the unit price of raw material. Similarly, stores, spares, consumables and packing

material have to be considered to arrive at the value of these, which will be kept in stock. It is also necessary to estimate the value of goods in process, which the enterprise will carry at any point of time. This will depend on the length of the manufacturing cycle. To estimate the value of goods in process, it is necessary to consider all direct costs like raw material, wages and utilities. Depreciation, administrative and selling costs may be ignored. It is also necessary to estimate the level of stock of finished goods, which the enterprise will generally carry. The quantity of finished goods stock should be valued at cost—direct as well as indirect excluding depreciation. Total sales need to be then segregated into cash sales and credit sales. The credit time limit will have to be assessed. This will furnish the amount of outstanding book debts. While fixing a value on sales, profit should be excluded and only the production cost of sales should be considered. The amount required to meet, say, one month's wages and salary bill and cost of fuel, light, power and other utilities for about a month may be estimated as also administrative and selling expenses and repairs and maintenance for a month. The total will help arrive at the gross working capital requirement. For purposes of valuation, a methodological schemata exists. But, analysis of business typology and market and input supply circumstance involves professional judgement. This is where a counsellor could play a facilitating role. This is why a counsellor needs to have a wider frame or reference and experience beyond mere expertise in the 'arithmetics' of analysis.

Management of working capital involves management of current assets and liabilities. Strategically managing the same warrants an analysis of the sector-market typology and production plan as also the customer and input-supply circumstance with reference to an enterprise. The professional expertise of a counsellor with rounded exposure to different enterprises and sector dynamics (and plans) is as critical as his expertise in 'book-keeping' arithmetics in order to facilitate the intervention.

Chapter 7

Essential Business Analysis and Management Tools for a Counsellor

An industrial counsellor may utilise certain rather simple analytical tools while pursuing a performance and potential analysis of an enterprise. Some of them are illustrated in this chapter. The chapter also presents certain 'minimum' and effective systems tools for decision-making in business.

A Note on the Cost Structure of a Business, Break-even Analysis and Leverages

Break-even analysis helps study the inter-relationship between costs, output and profit (COP) of an enterprise. Break-even level of activity is the level of production or sales at which total costs equal total revenue. The COP analysis helps study the effect of changes in costs, output and prices on profit and use this information in a revitalisation plan. Costs can be separated into fixed and variable.

Variable costs change in direct proportion to change in output while fixed costs remain constant. Each unit of product sold will cover its own variable cost and leave a balance (contribution) to cover fixed costs and profits. Total contribution is the difference between the sales revenue or output and total variable cost. Profit is derived when fixed costs are subtracted from the total contribution.

The estimation of break-even level of activity may be explored by means of an illustration: Assume a metalware manufacturing enterprise in Lucknow that produces a single variety of product (candle-stands) whose selling price is Rs 20 (per candle-stand) and the variable cost (per candle-stand) is Rs 15. The annual fixed costs of the enterprise are estimated as Rs 120,000. To break even the enterprise's contribution should be equal to fixed costs of Rs 120,000. The sale of one candle-stand creates a contribution of Rs 5. The enterprise must, therefore, sell 24,000 candle-stands to realise a total contribution of Rs 120,000.

The formula for estimation of breakeven is as follows:

$$\text{BEP (in rupees of sales) is therefore =} \\ \frac{\text{Fixed costs (total)}}{\text{Total sales realisation} - \text{Total variable cost}} \times 100$$

Once an enterprise has reached break-even activity, the difference between sales in excess of the break-even sales and variable costs are profits. Total fixed costs have already been covered at the break-even point.

Operating Leverage and Risk vs. Return Structuring of an Enterprise

Leverage is defined as a relative change in profits due to change in sales. A high degree of leverage implies that a large change in profits occurs due to a relatively

small change in sales. An enterprise will have higher operating leverage if total costs have a higher percentage of fixed costs. Operating leverage increases with fixed costs. Operating profit of a highly leveraged enterprise would increase at a faster rate for any given increase in sales. However, if sales fall, an enterprise with a high operating leverage would experience greater loss than an enterprise with low operating leverage.

Effects of Changes on Profits

A revitalisation plan must incorporate the fact that profits and its rate of increase or decline may be affected by the changes—increase/decrease, in any one or all of the following factors: Selling price; sales or output; variable costs and fixed costs.

The impact of the changes in variable costs on profit is straightforward if it does not cause any change in selling price or output. An increase in variable cost alone will increase break-even level of activity and reduce profits. However, if variable costs decline, break-even point will be lowered and profits would rise. A fall in fixed costs alone will, however, lower the break-even point and raise profits. An increase in fixed costs, will raise the break-even point. Increase in factory rent or salaries or interest on term loans are examples of factors that could lead to increase in fixed costs.

Cost Structure Analysis and Managerial Decisions

Costs or expenses include funds expended to make and sell a product. Understanding costs will help a small

entrepreneur to take 'make' or 'buy' decisions. That is, to manufacture in-house or to outsource; in pricing of products; decide on which product to offer discounts on; make quick business decisions; and, understand cost related risks in business.

Business Decisions: Implications of Break-even on Pricing

The illustration below indicates scope for pricing modes based on a study on break-even activity levels. The case is that of a jute mat making enterprise in Kolkata. Annual structure of costs of the enterprise is presented in Table 7.1.

Table 7.1: Annual Break-up of Costs of Jute Mat Manufacturing Enterprise in Kolkata

(Rs in million)

<i>Annual Break-up of Major Costs (On an Average)</i>	<i>Variable Cost</i>	<i>Fixed Cost</i>
Raw material	16,372,500	–
Electricity	375,000	2,800
Interest on working capital	700,000	–
Labour charges	562,500	–
Salary (management team)		120,000
Salary of manager cum accountant	72,000	–
Depreciation on equipment and building	–	92,000
Total cost	1,808,200	214,800

The selling price per mat is about Rs 115. Production capacity is 187,500 (three shifts per day for 250 days a year) pieces of mats a year. The maximum potential sales

revenue viz., the product of selling price per mat and production capacity is Rs 21,562,500. Total contribution is Rs 3,552,500. Break-even level of activity is, therefore, achieved at about 6 per cent capacity or with a production of about 11,500 mats.

Scope to Offer Discounts Once Break-even Point is Achieved

In the example presented above, let us assume that the manufacturer would be comfortable with a profit of only Rs 8 per mat. Let us also assume that he has already reached break-even level of activity. What is the price and discount he can now offer? The variable cost per mat is Rs 92. The selling price beyond break-even level including required profit margin is Rs 100. Therefore, the discount he can offer, as an incentive to increase sales is about 13 per cent.

Business Decisions: Other Pricing Methods

Pricing methods in simple terms are basically of three types: 'cost-plus' pricing; competitive pricing; and, Marginal or variable cost based pricing which has been discussed earlier. It is up to a promoter to decide which one to use based on market competition and preference of customers. Cost plus pricing may imply cost of production plus pricing viz., adding a profit margin to total cost of production of each unit produced. The buyer and seller may mutually agree on this margin. It may also imply capital cost plus pricing. Herein, it is necessary to decide the required appropriate annual return on initial investment or capital cost in the factory, estimating operating cost (annual fixed and variable costs of operation) and, price accordingly.

Competitors price their products at a certain rate for each type of product. A higher or lower price may be charged based on customer preference and product features. This is referred to as competitive pricing. In the case of marginal cost pricing, fixed costs are excluded in the costing exercise. As long as the enterprise is making other products or meeting other orders also as to contribute to cover fixed costs it could make the product. It will, therefore, effectively utilise capacity and also increase profits.

Business Decisions: Product Mix and Implications

An enterprise, often, has to be able to offer a variety of products to cater to the varying customers' demands. However, it may decide on an ideal production plan.

Consider the following case of an enterprise making coir products. The information provided below is for the year 2000–01.

(Rs in million)

<i>Item</i>	<i>Production (Sale in No. of Pieces)</i>	<i>Variable Cost/Unit</i>	<i>Selling Price (Market Rate)</i>	<i>Total Variable Cost</i>	<i>Total Sales Realisation</i>
Full jute mat	20,000	31	35	620,000	700,000
Full rubber mat	20,000	72	75	1,440,000	1,500,000
Latex backed coir mat	24,500	92	115	2,254,500	2,817,500
Total				4,314,000	5,017,500

Let us assume that this enterprise is operating on a single shift basis for 250 days a year. Fixed costs are Rs 120,000 per year. Profit made by the workshop in the year 2001–02 is: Sales realisation – Total variable cost – Fixed cost or Rs 583,500 in total.

How can this enterprise improve its performance? The enterprise can make more exporters and traders buy its products. It can offer a selling incentive in terms of a price discount in the sale of latex backed coir mats. If it incorporates this selling stratagem for 2002, it may offer a discount of 10 per cent in the price of latex based coir mats. Latex-based coir mats yield highest 'contribution'. 'Contribution' (per piece) is the difference between selling price and variable cost (per piece). The enterprise could then secure more orders for making latex based coir mats. Theirs could now be cheaper compared to that of competitors. The enterprise could avoid making other items unless spare capacity exists.

The projected sales, cost and profit picture for 2002 may therefore be:

(Rs in million)

<i>Item</i>	<i>Production in No. of Pieces</i>	<i>Variable Cost/Unit</i>	<i>Selling Price</i>	<i>Total Variable Cost</i>	<i>Total Sales Realisation</i>
Latex based coir mats	64,500	92	103.5q	5,934,000	6,675,750
Total				5,934,000	6,675,750

Fixed cost equals Rs 120,000 and Profit, that is, Total sales realisation – Total variable cost – Fixed cost equals Rs 621,750.

Hence, profit can be increased by Rs 38,250 by changing the product mix. In fact, it can be increased several times over viz., by over Rs 100,000 if it now operates on three shift basis and demand exists. However, a counsellor need remember that market demand is the basis for a change in the product mix. An attractive (discount) strategy may be used on this basis.

Business Decision: To Manufacture In-house or to Outsource?

Does a manufacturer need to employ more labour on salary basis in production and hence increase fixed costs? Should a merchant exporter need to purchase equipment and hence bear higher fixed cost in terms of depreciation and interest cost on money borrowed for purchase of this equipment than outsource production? These are questions that could be resolved by efficient counselling. The following example will help realise the basis for such decisions:

Example: Consider the two enterprises making brass taps in Jamnagar below:

Exporter 1 pursues largely outsourced manufacture. Few equipment other than finishing and few salaried workers are used.

Exporter 2 pursues largely in-house manufacture. The complete manufacturing base is in-house. The enterprise has also taken a bank loan for buying more equipment to avoid outsourcing.

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Scenario 1: Assume current sale for the year 2001–02 is 1,87,500 pieces of taps of standard variety

	<i>Enterprise 1</i> (Rs on per-piece basis)	<i>Enterprise 2</i> (Rs on per-piece basis)
Sales	187,500 pieces	187,500 pieces
Selling price	125	125
Variable cost	115	92
<i>Contribution per piece</i>	10	33
	(Rs Total)	(Rs Total)
Sales turnover	23,437,500	23,437,500
Total variable cost	21,562,500	17,250,500
<i>Total contribution</i>	1,875,000	6,187,500
Fixed cost	700,000	3,100,000
<i>Profit</i>	1,175,000	3,087,500

Scenario 2: Assume, sales increases by 20 per cent next year (2001) viz., capacity utilisation increases

	<i>Enterprise 1</i>	<i>Enterprise 2</i>
Sales volume	225,000	225,000
Price	125	125
Variable cost	115	92
<i>Contribution</i>	10	33
<i>Total contribution</i>	2,250,000	7,425,000
Fixed cost	700,000	3,100,000
<i>Profit</i>	1,550,000	4,325,000

Study the increase in sales (20 per cent) and increase in profits in the two enterprises. Which enterprise is ideal in terms of its cost structure? Consider Table 7.2 given on the following page.

Table 7.2: Comparison of Sales and Profits

	<i>Enterprise 1</i>	<i>Enterprise 2</i>
Increase in sales	20%	20%
Increase in profits	31.9%	40%

The above table indicates that the rate of increase in profit is higher in enterprises where fixed costs are higher and variable costs lower. However, if there is a fall in sales, the decrease in profit will also be at the same rate!

Hence, the decision on manufacturing mostly in-house or to outsource manufacture needs rest on confidence with regard to sales and capacity utilisation. If break-even is expected to be easily achieved, the structure of costs in the enterprise, wherein, higher contribution (or lower variable costs) and a greater fixed cost exists, is ideal.

Business Decision: To Accept or Reject an Offer

The advantage of maintaining estimates of cost structure of an enterprise is also with regard to facilitating speed in decision-making. The example of a small chemical manufacturer in Table 7.3 shows this.

Table 7.3: Cost Structure and Activity of an Enterprise for the Year 2000–01

Sales (10,000 kg @ Rs 75 each)	: 750,000
Variable cost (10,000 kg @ Rs 65 each)	: 650,000
Contribution	: 100,000
Fixed cost	: 10,000
Profit	: 90,000

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Assume the enterprise now receives an offer from an exporter with the following terms:

1. Offer of increase in price = 20 per cent	2. Reduction in sales = 20 per cent (As the exporter would like the enterprise to manufacture for him alone)
3. Variable expenses (increase) = 20 per cent (in terms of better quality raw material cost)	4. Fixed cost increase = 5 per cent (in terms of additional expense on upgrading equipment)

Would profits increase or decrease if the enterprise accepts the offer? Cost structure and activity of the enterprise if the enterprise accepts the offer:

Production	8,000 kg	Total sales	Rs 720,000
Price	Rs 90 per kg	Total variable	Rs 624,000
		Cost	
Variable cost	Rs 78 per kg	Fixed cost	Rs 10,500
		Profit	Rs 85,500

Profits fall by Rs 4,500 if the enterprise accepts this offer. This decision to reject the offer may be made easily if the enterprise maintains data on its cost structure.

Costs and Risk in Business... Yet Another Illustration

Risk in business as a result of its costs may be, therefore, evaluated in terms of changes in profit as a result of changes in turnover. The following example

shows the extent of such risks in a small (product exporting) enterprise:

	<i>Current Position</i>
Turnover or sales	Rs 2,343,750 (2,320,312 = 1% fall)
Variable cost (except opp. interest cost)	Rs 2,156,250
Total contribution	Rs 187,500 (1)
Fixed cost	Rs 70,000 (2)
Profit before tax {(1) – (2)}	Rs 117,500 (115,737.5 = 1.5% fall)

Assume there is a 1 per cent fall in turnover or sales from current position in an enterprise.

The formula to estimate fall in profit with a fall in sales is Contribution/profit before tax. This indicates risk in business. With a 1 per cent fall in sales there is a 1.5 per cent fall in profits. However, with a 1 per cent rise in sales the impact on profits would be the same.

Similarly, the risk in business in a brassware manufacturing cum exporting enterprise in Moradabad is as follows:

Turnover or sales	=	Rs 2,343,750
Variable cost	=	Rs 1,725,000
Total contribution	=	Rs 618,750 (1)
Fixed cost	=	Rs 110,000 (2)
Profit {(1) – (2)}	=	Rs 508,750

In this case contribution/'profit' works out to be 1.21. A small manufacturer and exporter in this category hardly come under the 'tax bracket' and hence the financial leveraging aspect may be ignored.

An industrial counsellor needs to utilise different tools of analysis over his intervention. Quantitative tools merely offer a methodology. They need to be synergised with the 'frames of reference' and insights of a counsellor as to be customised for each enterprise.

Management Information and Control Systems (MICS) remain a neglected area in small enterprise management. As an illustration, consider the case of Nayana Enterprises which was established in 1999 as a partnership concern. The enterprise manufactures jute mats. The enterprise buys semi-finished mats from tiny manufacturers and undertakes processing and finishing. The enterprise markets its products in the domestic market. A study on the process, capacity and economic order of purchase illustrates the need for systems in the production front.

Capacity Balancing and Economic Order Quantity (EOQ) in Purchase

Based on lot size and time required, the process incorporated in the enterprise involves eight hours in 'shearing' and 'trimming' respectively for the same lot size of 2,000 pieces. This in effect is about 2,000 pieces per shift. While in the packing stage it takes about 10 hours to complete 1,000 pieces. This works out to only 800 pieces per shift. Hence, there is a capacity imbalance in the manufacturing process. Packing is a bottleneck leading to imbalancing. Capacities of other processes are under-utilised. The unit has sufficient demand to operate at more than two shifts. Hence, additional equipment has to be installed in the packing phase to correct line misbalancing.

MICS for a small enterprise could also include utilisation of production and scrap reports on a daily basis, batch consumption reports, material utilisation reports, and production reports on a monthly basis and, a purchase and a stores ledger. In addition to this, most critically, the EOQ at the enterprise level has to be estimated to facilitate purchase and stocking decisions. For instance, in a jute mat manufacturing enterprise the expected raw material requirement is 100,000 kg of jute during the next year. The enterprise works at an average for 300 days a year. The cost of processing an order is Rs 40 and the carrying cost per kg of jute is Rs 1 for one year. Lead time on an order is six days and the enterprise may keep a reserve stock of three days usage. The economic order quantity and the re-order point may be estimated incorporating the formula:

$$EOQ = \sqrt{\frac{2AO}{C}}$$

where A is the annual requirement of input, O is the ordering cost (communication, transport, etc.) and C is the carrying cost (storage, etc.).

$$= \sqrt{\frac{2 \times 100,000 \times 40}{1}} = \sqrt{8,000,000}$$

$$= 2,828 \text{ kg (approximately)}$$

The re-order point may be estimated as follows:

$$\text{Daily usage} = 100,000/300 = 333 \text{ kg}$$

$$\begin{aligned} \text{Reorder point} &= \text{Safety stock} \times \text{Usage} + \text{Lead time} \\ &\quad \times \text{Usage} \\ &= 3 (333) + 6 (333) = 2,997 \end{aligned}$$

As a second illustration, consider the concept of a simple systems tool presented below as also the case of a tiny coir matting's enterprise.

Cash (Liquidity) and Cost (Profitability– Risk) Management

The systems for cash management are equally important. Cash is oxygen for business. What happens if a business suddenly runs out of cash? An enterprise may not be able to pay its dues on time. This will destroy its creditworthiness. Also, an enterprise may not be able to take advantage of opportunities because of a lack of funds to finance them. A portion of the profit should be saved and ploughed back into business as retained earnings. Continuous informal borrowing will put pressures on an entrepreneur to pay high interest and could affect credibility. All cash receipts and expenses should be regularly recorded so that one may see the flow of money in business everyday. It is necessary to try to pay in cash perhaps by means of offering a discount at the time of sale if one believes that one could have a cash problem. A simple but extremely utilitarian tool appropriate for business decision-making is a cash cum income and cost sheet.

A cash cum income and cost sheet allows keeping records of cash, income and costs. But, more importantly, it helps decision-making on purchase and sales (discount vs. credit) and on structuring of costs to take advantage of leveraging effect of fixed costs on profits, or alternatively, reduce business risk.

Cash transactions may be recorded on the left page. Cash received, cash disbursed, investments, revenues and costs may be recorded on the right page. Incomes are cash received and costs are cash disbursed.

As an illustration, consider a coir matting enterprise. The enterprise has about Rs 50,000 as cash balance as on February 1, 2001 and used it to buy material worth Rs 8,000 on February 10, 2001. On February 13, the enterprise again bought raw material for Rs 5,000 and paid rental charges totalling Rs 8,000. On February 25, there was some sale of coir products to an exporter for Rs 20,000. On February 27, the enterprise sold more products to another trader for Rs 82,000. On February 28, the enterprise bought raw material for Rs 70,000. These transactions are recorded in the following cash cum cost sheet.

LEFT PAGE (CASH SHEET)					
<i>Date</i>	<i>Explanation</i>	<i>To/From</i>	<i>Cash Received</i>	<i>Cash Disbursed</i>	<i>Cash Balance</i>
2/1					50,000
2/10	Bought fibre	Guru		8,000	42,000
2/13	Bought dyes	Sailesh		5,000	37,000
	Paid rent (annual lease arrangement paid every two months)			8,000	29,000
2/25	Sold coir mats	Ashok (exporter)	20,000		49,000
2/27	Sold coir product	Habib Traders	82,000		131,000
2/28	Paid wages (piece-rate)	Employees		70,000	61,000
	Total		102,000	91,000	

RIGHT PAGE (COST SHEET)			
<i>Start Up/Investment</i>	<i>Income</i>	<i>Variable Cost</i>	<i>Fixed Cost</i>
50,000			
		8,000	
		5,000	
			8,000
	20,000		
	82,000		
		70,000	
50,000	102,000	83,000	8,000

All expenses are recorded as variable or fixed costs simultaneously. Such a systems tool facilitates decision-making on the purchase, sale and 'out-sourcing' or profitability front. For instance: Measures to consider when expecting cash shortages include shorter periods for credit sales and perhaps a discount for cash sales; suppliers may be requested for credit; equipment and purchase of fixed assets may be delayed. One may also reduce business risks, by reducing fixed costs, perhaps by discontinuing annual lease arrangement and utilising idle capacity of other enterprises on a weekly basis if sales position is weak or uncertain. Alternatively, one may enhance the potential for increasing returns or margins by converting piece-rate to salaried labour if cash balance is relatively higher and market demand exists. Costs, may hence, be reduced and margins increased. That is converting variable costs into fixed costs. Almost all variable costs may be converted into fixed costs and vice versa. A counsellor has a critical role to plan in implementing such systems in business.

Chapter 8

Evolving 'Networked' Business Plans: Scope for Counselling on Options

Hard network or consortia building is a key success determinant for small enterprises. It could contribute to cost and/or risk reduction and/or enhance bargaining power of small enterprises. A network may comprise a few small enterprises that work together for mutual gain. Benefits may, for instance, be in terms of reaping benefits of economies of scale in marketing or raw material purchase. Networks may vary in terms of structure and size depending on the objectives. Networks may be either horizontal or vertical. A vertical network is a linkage of enterprises along the supply chain. A large brassware exporter in Moradabad may establish a network with a group of smaller processors or agents who in turn source their inputs from other brassware manufacturers. A horizontal network is one across similar enterprises, say, brassware exporters. The size of a network would depend on the objective of its conception. If it has a mandate of

representing issues to authorities, a large network could make such representation credible. If the objective is to purchase raw material in bulk as to benefit from quantity discounts from suppliers, the optimal size of the network will depend on the purchasing and utilisation capacity of members as also on the optimal volumes for which such discounts are made available by suppliers. Networks may also be 'soft' or 'hard'. A soft network may not be established for immediate commercial gain in terms of pursuing a common business plan. A soft network may be in terms of an 'association' of enterprises for representing problems of members to relevant authorities. The term 'network' as stressed in this book refers to hard networks.

Consider the coir cluster at Alleppey, for instance: There are three tiers along the supply chain Tier 1: Small exporters. Tier 2: Small product manufacturers and, Tier 3: Small yarn manufacturers. Raw material costs are the most significant costs for manufacturers. With global recession and cost competition from substitute products such as jute and 'China grass', a major imperative for small manufacturers as also exporters is to reduce costs and improve margins. The Coir Board, Entrepreneurship Development Institute of India, Ahmedabad (EDI) and some small enterprises together conceived a plan to reduce costs. The focus being on optimal quantity of bulk purchase of raw material together, in cash, as to avail of both cash and quantity discounts. This business plan involved decisions on the size of such a purchase consortium, the capacity of member manufacturing units to process and sell such raw material purchased, etc. The need to integrate purchase and sale decision necessitated that exporters or traders also be involved in the schemat, wherein, manufacturers play the critical role. The need to involve yarn manufacturers was also perceived as they are suppliers of raw material. The definition of business relationship along the supply chain in this plan involved commitment by consortiums or network actors on Tier 2 and 3 to offer

to supply materials at discounted rates to those in higher Tiers if minimum bulk and cash orders are demanded viz., from networked enterprises in Tier 1 and Tier 2, respectively. Selection of subcontractors viz., actors along Tier 2 and 3 involved identifying small manufacturers who are willing to 'together' purchase and supply material in required quantities so as to benefit from the concept. The size of the group across the three Tiers had been conceived on this basis. If such projects are implemented in coir clusters effectively, benefit of economies of scale on purchase and marketing could be reaped even amongst smaller enterprises along the supply chain. A counsellor needs to evolve such options over interventions on small enterprises.

It is not only smaller enterprises which may benefit from hard networks—horizontal or vertical. Larger exporters could horizontally network for brand building or for creating large common facilities. They could benefit by encouraging smaller networks of manufacturers to develop resources to cater to their requirements more efficiently. Large input traders or yarn manufacturers could also benefit from bulk off-take from networks of small manufacturers. Smaller exporters who find it difficult to cater to bulk orders could network to explore new customers either in segment or geographic terms. All, in effect, proving beneficial to a sector as a whole. The modalities of formation and implementation of different 'hard' networking options are explored below.

Networking initiatives that may be pursued by small enterprises illustratively include: (1) Formation and development of export or marketing consortia; (2) Establishing mutual credit guarantee funds; (3) Development and support of subcontraction exchanges; (4) Establishing purchase consortia; (5) Development of common facility centres; (6) Common branding; (7) Commonly avail of training and business counselling related support.

As a part of export or marketing consortia, per enterprise, cost reduction options such as development of common websites and/or catalogues may be considered. Common branding is also a relevant networking option. The objectives may be to reduce unit costs or to approach volumes requiring buyers or global 'retailers'. Training and business assistance programmes may be the most widely employed instruments. Sharing of relevant costs by groups of small enterprises could help redress the financial burden on individual enterprises. Similarly, catalogue shows, common booking of stalls in fairs abroad and, buyer-seller meets are other common initiatives that may be pursued by small enterprises. Efficient counselling on the crystallisation and implementation of such 'group' plans for enterprises is a critical aspect of the counselling exercise.

Formation and Development of Export or Marketing Consortia

A consortia is a strategic 'hard' network between enterprises, which target to jointly achieve business benefits. Export consortia strive to exploit export markets. There are, in effect, two major reasons for forming export or market consortia. The first, is to reduce per enterprise cost involved in marketing or market development. Advanced web pages, catalogues, sample development and participation in reputed Indian and, particularly, international trade fairs are an expensive proposition. A group of small enterprises could share relevant costs, substantially, reducing costs per enterprise. The second, is to access volumes markets or marketing channels (either for customised or more usually) for standard products. Many large 'retail' customers in international markets such as America are usually represented by customers demanding volumes. Under this option, homogeneity of products,

prices etc., are critical aspects determining sustainability of the common business plan. Counsellors may help in evolving market promotion, segmentation and pricing strategies. Developing of an information base of potential customers, scope for converting customers of 'other' household furnishing products into coir 'door-mat' customers may all be explored.

To be able to promote and facilitate marketing of products of consortia, counsellors may offer services such as quality control services, ideal sources for common raw material buying, information about markets and fair trade agencies such as the South Indian Producers Association (SIPA) that help utilise development agencies abroad like the Centre for Promotion of Imports from Developing Countries to market products. The main advantage of market consortia is that by operating through one representative who co-ordinates selling, the power of enterprises increases. Unit costs are reduced and access into markets requiring large volumes are facilitated. Consider the example of the terry towel manufacturing enterprises in Sholapur, Maharashtra.

While indicating marketing options, the case highlights that marketing networks are not exclusive of those meant for other purposes. Networks for common purchase and networks for establishing CFCs may have to be simultaneously exported to make the marketing front viable. The 'larger' enterprises in Sholapur with a turnover of between Rs 2 to Rs 4 crore indirectly export while most of the 'smaller' manufacturers largely focus on the domestic market. The break-even level of activity of a 'larger' small enterprise in the region is very low. Raw material costs are, for instance, about 70 per cent of total annual cost of production, chemicals and dyes (6 per cent), power and electricity (1.25 per cent) and wages (5.75 per cent). Interest on working capital is about Rs 600,000. Such an enterprise has a cash credit facility of about Rs 3.5 million. Job working charges are paid at about Rs 2 million. The

total expenses work out to about Rs 31.5 million as variable costs and about Rs 1 million in terms of fixed costs as salary and depreciation related expenditure. The relatively low fixed costs help enterprises achieve break-even quicker. Business risk is very low. Some enterprises like the one considered in the illustration above operate with own looms. A common facility-dyeing unit established and operated by a network of manufacturers in the region could help reduce manufacturing costs by about 5 per cent. Even a relatively 'larger' manufacturer in Sholapur cannot utilise such an optimal capacity sized unit. Hence, a networked initiative is an obvious imperative for this. The utilisation of elementary management tools such as marginal cost pricing upon appropriate market segmentation could help these indirect exporters gain an entry into markets easily. Export market sales may be on an appropriate mark up on variable costs.

The average small manufacturer in Sholapur operates with about 12 looms. On a 12-hour shift basis, a single loom can produce up to 4.5 tonnes per month (TPM). Therefore, the enterprise produces up to 54 TPA at Rs 160/kg. Sales realisation, is therefore, about Rs 8.6 million per annum. Margins (on sales) of such enterprises are about five to seven per cent. Margins are believed to have fallen by up to 50 per cent in the past four to five years. Hardly in coincidence with the South East Asian currency crisis of 1996-97! China remains a major competitor. Turkey and Portugal are believed to be competitors in the upper-price segment of higher quality towels. Raw material yarn is sourced from local traders at one-month credit and chemicals and dyes on two-month credit. The rates per month of credit for these two critical inputs are about 2 per cent per month. Ideal sourcing, bulk sourcing and avoiding credit purchase may help increase margins of the average enterprise by 50 per cent. The medium sized manufacturers may form a 'small demonstration network' and source yarn in bulk (and cash) of about 500 TPM at

Rs 80/kg or a total of Rs 40 million. By sourcing in bulk, a discount of up to 2 per cent may be secured from spinning mills. However, if the enterprise pursues the option of bulk import of cotton on networked basis (perhaps on an advance licence mode) and operate a spinning mill on lease basis, greater scope for reducing cost exists. These days when job workers are temporarily operating on thin margins and outsourcing manufacture on job-worked basis is cheaper than in-house manufacture, networking to pursue such interventions may obviously be a necessary option in the long term. Investing in fixed costs and backward integration is an option to reduce costs and enhance profitability.

So also, a 'similar' network of 10 enterprises in the region requires about Rs 4 million of chemicals and dyes a month. The same may be sourced from manufacturing bases such as Ahmedabad and South Korea. This common business plan may involve purchase of chemicals like hydrogen peroxide and chlorine for about Rs 2.4 million and reactives and direct dyes for about Rs 1.6 million.

However, a necessary imperative for such efficient sourcing particularly, from abroad is (direct) export orientation. The vast majority of enterprises in the region are indirect exporters. Hence, counselling on this is imperative. An action plan for developing of enterprises in the region could involve segregating the key SME actors into 'larger' small and small manufacturers. The 'larger' small manufacturers may focus on exploring avenues for direct exports into 'volumes' demanding markets. The subsidised services of international development agencies such as the Netherland Management Co-operation Programme (NMCP) and the Centre for Promotion of Imports from Developing Countries, both, based in the Netherlands may be utilised for this purpose. The larger exporters may focus on 'volumes' markets such as Latin and North America. Small manufacturer networks may focus on, South African and Middle Eastern markets. The services of developmental and industry trade promotion bodies in

India such as the National Small Industries Corporation (NSIC) which have offices in South Africa and the Middle-East to promote business ties, the consulates of relevant countries and Indian Trade Promotion Organisation (ITPO) networks may be utilised effectively for this purpose. The Market Development Assistance Scheme of the Development Commissioner—Small Scale Industries (DCSSI) in terms of subsidised travel may also be utilised by potential exporters. Further, the 'cash-rich' 'larger' small sized manufacturers with a turnover in the range of Rs 20–40 million may not have to utilise the financing facility of the NSIC sans collateral (but with bank guarantee)! However, the smaller manufacturers may explore this option for raw material purchase in bulk and when and where appropriate source raw material from abroad on advance licence basis.

Establishing Mutual Credit Guarantee Funds

A guarantee fund helps canalise long and short term financial resources from institutions to enterprises. This is, particularly, when small enterprises cannot offer necessary collateral for formal financing. The guarantee funds can help generate institutional finance for entrepreneurs, permitting network members easy access to credit required for financing business. Guarantee funds may be created with a co-operative effort of SIDBI, commercial banks and entrepreneur networks.

Estimating fund requirements, evolving an optimal utilisation plan and conceiving the systems for successful and sustainable implementation of the project is an activity under the ambit of an industrial counsellor. To ensure that the number of failed operations be the minimum possible, counsellors could be involved in follow-up of commitments and obligations by members. Identification of NGOs and their capacity building to serve as an implementing agency

may also be explored. Counsellors, directly or through NGOs, could assume the responsibility for supervising and co-ordinating the scheme, and establish and maintain relations with financial bodies and other organisations. The counsellor also has to ensure that maximum number of small entrepreneurs and their networks benefit from such schemes.

Financial instruments such as the Mutual Credit Guarantee Fund are, therefore, a remedy to the inability of small enterprises to secure adequate formal institutional finance. They also help reduce the cost of capital of smaller units which rely on costly informal sources of finance as also enhance margins by converting job workers to own working capital operated enterprises.

In the coir product cluster at Alleppey, EDI, the Coir Board, the SIDBI and the SBI have succeeded in addressing the credit needs of small mat manufacturers through a Mutual Credit Guarantee Fund Scheme (MCGFS). The Mutual Credit Guarantee Fund Scheme was especially evolved as manufacturers did not have the means to provide collateral guarantee to secure bank finance. This particular scheme as is being implemented in a few clusters in the country has so far benefited hundreds of small enterprises. An established NGO sometimes serves as the broker unit to implement the scheme. Various modifications of the scheme are possible based on circumstances and extent of support that other agencies such as NABARD and commercial banks offer. The United Nations Industrial Development Organisation, Cluster Development Programme (UNIDO, CDP) had initially conceived this specific instrument.

Development of Sub-contraction Exchanges

Industrial sub-contraction exchanges are modes of cooperation between enterprises. They help greater

linkage of enterprises, which offer goods, and services to enterprises that require such products. The sub-contraction exchanges develop a database of information. Industrial counsellors may validate capacities in the sub-contracted enterprises and the products or services that the latter offer. This database is consulted by customer enterprises along the supply chain for processes, products and services so as to identify a possible supplier. Sub-contraction exchanges could simplify the search for suppliers by enterprises and better the decision-making of investments by enterprises and enable them to have flexibility in production, facilitating identification of capacities available in other enterprises. Hence, a merchant exporter may also post information to seek linkages along the chain of production. An importer may seek suppliers from larger exporters. A counsellor could help the sub-contraction exchange function smoothly by regularly validating information on the database and help facilitate adjustments that enterprises involved in the sub-contraction process have to make like the adoption of new technologies and betterment of quality standards.

In the SISI, at Chennai, a subcontracting exchange has been established with the support of the Development Commissioner (SSI). DC (SSI) contributes about Rs 450,000 for hardware and Rs 150,000 for running expenses. The subcontracting exchanges could in effect be technical information, market promotion and match making centres for industrial subcontracting and partnerships. It is targeted at enhancing effective utilisation of manufacturing capacities of SMEs in a region. The subcontracting exchange could also, in effect, help tap bulk buyers better when small enterprises in the region are unable to cater due to their fragmented capacities. The SISI, at Chennai, passes on requests received from large public sector enterprises to members of the exchange manned by them.

Develop Raw Material Purchase Consortia or 'Raw Material Banks'

Input supplies to individual enterprises may be bought in volumes meriting discounts. Purchase consortia lend strength to small enterprises vis-à-vis suppliers. An MCGF scheme may also, in effect, help facilitate development of such a consortia. To successfully promote and facilitate a purchase consortia, counsellors could provide certain specialised services. These services may include: Monitoring production plan of members and formulating the purchase scheme (individual enterprise EOQ and 'group' based EOQ), leveraging institutional finance, providing information about raw material and input sources, etc. Chemical and dyes prices at Ahmedabad or polypropylene prices at Chennai, Ahmedabad and Mumbai may be far cheaper if sourced in bulk volumes. Rubber related items sourced at about Rs 50 lakh bulk and cash purchase may merit discount (cash and bulk) of even up to 5 per cent while coir products may secure discounts of only about 3 per cent for every Rs 20 lakh of purchase. However, chemicals and dyes if optimally sourced and secured in bulk may help realise discounts of even up to 20 per cent.

Dis-optimal raw material purchase price of various inputs (as it is) on credit purchase basis and often in uneconomic quantity, affects the cost structure of many smaller enterprises in different sectors.

A Raw Material Purchase Consortium Exemplified: As a Mere Illustration

Many coir and natural fibre related units purchase fibre/yarn and chemicals etc., in uneconomical quantities on credit basis. As a result, they are unable to avail of cash

and quantity discounts. Cash and quantity discounts could amount to at least 3–10 per cent. The details are worked out for a Rs 2 million working capital facility based purchase in the following statements. It is inferred that in a demonstration bank almost Rs 163,000 can be saved by a consortium per rotation or cycle due to cash and bulk purchase of economic order quantity. The annual estimated savings of a consortium enterprise employing working capital of about Rs 2 million for purchase is Rs 13.04.

The amount of working capital fund required for purchase based on economic order quantity is also estimated at Rs 2 million. Eight rotations may be expected per year. The working capital cycle being for 45 days. This includes purchase, stocking period and credit sale period. The common initiative may be pursued by a self (equity) financed initiative or by accessing working capital support from a financial institution.

Return on investment (pre-tax) such as a 100 per cent equity financed consortium in terms of cost reduced operation is over 60 per cent. Even if partly bank (debt for working capital) financed, ROE is likely to be very high depending on the extent of rotation and amount and cost of working capital secured. Table 8.1 highlights the benefits in detail.

They vary over time. Items like rubber/latex may also be considered. The benefit on operation excluding overheads and investor service fees is Rs 163,000 per rotation. The total working capital fund required is Rs 1,998,000 or approximately Rs 2 million. The operation plan of such an initiative is given in Figure 8.1.

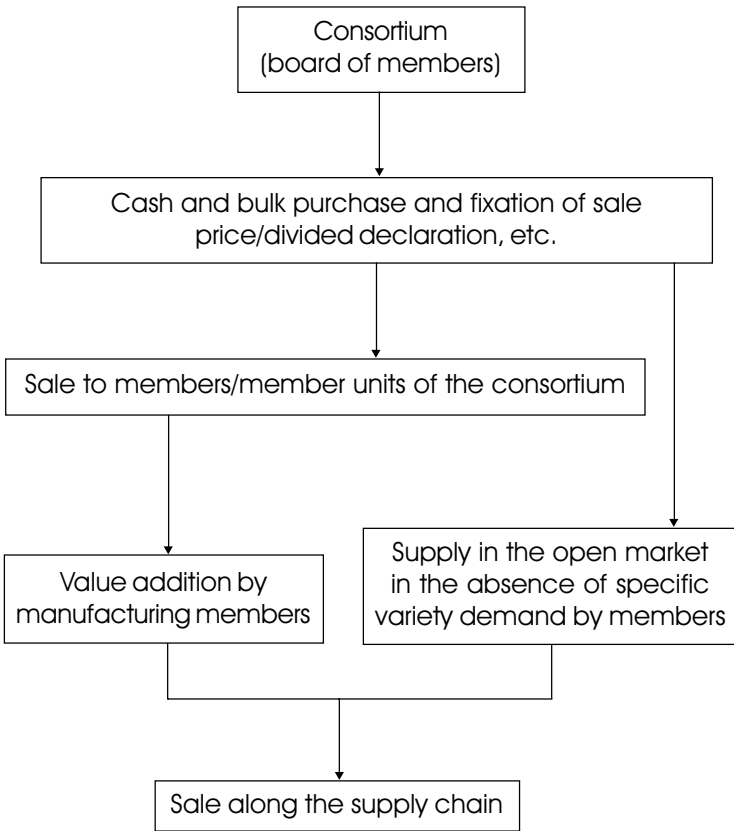
Development of Common Facility Centres

Common facility centres (CFCs) provide necessary support services to smaller enterprises. Shared facilities

Table 8.1: Approximate Indications of Rates

Sr. No.	Raw Material	Quantity in Tonne (Bulk)	Market Rate/Tonne (Rs Converted Kg, Rates)	Bulk Qty. Rate/Tonne (Rs)	Amount (Rs)	Amount (Bulk Purchase) (Rs)
1.	Fibre DF	20	9,000	8,000	180,000	160,000
2.	Vaikom coir	10	17,000	16,000	170,000	160,000
3.	Aratory 240/260	10	23,000	21,000	230,000	210,000
4.	Aratory 260/280	10	24,000	23,000	240,000	230,000
5.	Angengo 240/260	10	31,000	29,000	310,000	290,000
6.	Spl. C1 Vaikom	5	27,000	26,000	135,000	130,000
7.	Real Alappad	5	15,000	14,000	75,000	70,000
8.	Jute 2 Ply	5	28,000	26,000	140,000	130,000
9.	Jute 5 ply spl	10	31,000	29,000	310,000	290,000
10.	Chemical (H ₂ O ₂)	4	28,000	25,000	112,000	100,000
11.	Chemical (Kera White)	4	8,000	7,000	32,000	28,000
12.	Alum	1	10,000	8,000	10,000	8,000
13.	Dyes	0.5	350,000	300,000	175,000	150,000
	Total				2,119,000	1,956,000

Figure 8.1: Operational Plan of a Raw Material Purchase Consortium (also a common facility)



may be in terms of research and development and, product testing and standardisation. The Peenya Industries Association in Bangalore has, for example, established a permanent exhibition cum display centre for members' products. These centres could be supported by various ministries such as the ministry of SSI and ARI, DC (SSI), etc. Common Facility Centres help SMEs utilise expensive facilities, which they as individual enterprises cannot afford to develop and use.

Counsellors have an important role in forming common facility centres in terms of identifying options preparing a project plan and encouraging private participation in evolving and setting up these centres.

Common Branding

Common branding is a means by which small enterprises may develop customer and consumer loyalty and preference for their products. Common branding is useful as a sustainable marketing tool for small enterprises that wish to build real and notional differentiation. It has the ability to develop market loyalty in sectors where largely smaller or medium enterprises may join hands to build marketing muscle. It helps secure higher margins for products in some cases. It also ensures greater networking amongst enterprises as to avoid mutually detrimental cost-based competition. A counsellor may play a critical role in pursuing a cost-benefit analysis of different options in this regard.

As an example, common branding was taken up as a strategic initiative in Tirupur. About 40 exporters joined the programme and Rs 100,000 was contributed by each towards meeting the initial costs of the exercise. A core committee to monitor and co-ordinate various issues relating to promotion of a common brand has been developed. The small entrepreneurs need to learn from the experience of Tirupur cotton 'natural-fibre' based entrepreneurs.

Training and Business Counselling Offered to Networks

Training and business counselling may also be offered on a networked basis. Counsellors may directly

offer services in the context of management upgradation and in effectively tapping international development agencies such as the Netherlands Management Co-operation Programme (NMCP) and the CBI based in the Netherlands to facilitate technical and marketing counselling, in particular. Training is oriented towards developing skills in the entrepreneur or employees for better performance by the enterprise. Regular offer of management and business administration programmes for small enterprises in co-operation with industry associations is not beyond the scope of a counsellor. Some bodies that may offer financial support for training and counselling include the Government of India and various ministries and SIDBI, NABARD, SBI (Uptech Project) and the Department of Science and Technology (DST).

Counsellors need to develop and disseminate (a warehouse of) information on ideal financing schemes, on market promotion agencies, and on other private and public BDS providers. The advantage (especially of 'group' training and counselling) includes offer of a low cost option for enterprises in areas like productivity and development of managerial abilities. Group based ISO systems implementation could also help reduce relevant costs on a per enterprise basis especially on the ISO training front. Scientific management systems may also be installed in small enterprises on a 'group' mode.

The cases on 'powerloom' related enterprises at Ichalkaranji, Maharashtra indicates the various options for networking as a further illustration. The example also indicates the need for management upgradation before focusing on costing and pricing. In a sector, options will vary based on different typologies and locational stratum of enterprises.

Options for Small and Tiny Powerloom Manufacturers: An Illustration

Small powerloom weavers who indirectly export with turnovers in the range of Rs 10 million with own working capital need to upgrade management styles. For instance, consider the costing and pricing strategy adopted by a sample unit (figures in rupees per linear metre)—Paree Powerlooms.

Given the costing estimates arrived at by the methodology presented in Table 8.2 selling price is set at Rs 30 per linear metre. Therefore, net profit margin equals Rs 30.00 minus Rs 28.24 or 1.76 or about 6 per cent.

Table 8.2: Costing Methodology of Paree Powerlooms, Ichalkaranji

<i>Sr. No.</i>	<i>Costing (Per Linear Metre)</i>	<i>Variable Cost</i>
1.	Yarn cost	18.50
2.	Sizing cost	1.20
3.	Brokerage expenses	0.60
4.	Seconds (rejection) sale	0.30
5.	Interest (process) (30 days-2%)	0.60
6.	Weaving	7.04
	Total	28.24

The enterprises produce only 'grey' fabric and hence no chemicals and dyes are used. They sell on the basis of two months credit at additional credit cost of a total 4 per cent of purchase. The scope for marginal costing on the basis of appropriate market segmentation, for instance, is ignored. Consider the data for a similar unit Nityanand enterprises with a turnover of about Rs 12 million per annum. It is operating for about three shifts (or,

effectively 20 hrs.) for 300 days a year. The average cost for their fabric (for example) is about Rs 30 per m. In a day about 45 m are produced. Total sales realisation for 45 m therefore works out to Rs 1,350 and in (300 days) a year, it works out to Rs 405,000. This unit regularly job-works 30 looms and total turnover equals 4.05×30 looms or Rs 12,150,000. The unit produces 405,000 m (30 looms producing 45 m/day/loom for 300 days).

A cost structure analysis of the enterprise reveals scope of various options, that is, on the networking, costing and pricing front.

As indicated in Table 8.3 given on the following page even prior to establishing networks, merely utilising looms on lease basis may help reduce relevant costs significantly! The example also highlights options for pricing. For instance, under this circumstance, the cost and risk profile of the enterprise is as follows:

$$\text{BEP} = \frac{2.851}{12.1 - 8.593} = \frac{2.851}{3.507} = 81\%$$

or at about Rs 9.5 million

$$(i) \text{ Total cost} = 2.851 + 8.593 = 11.444$$

$$(ii) \text{ TC/Metre} = \frac{11.444}{4,05,000 \text{ m}} = 28.3$$

$$(iii) \text{ VC/Metre} = \frac{8.593}{4,05,000 \text{ m}} = 21.2$$

Scope for effectively employing marginal cost pricing modes exist. Beyond break-even sales variable costs could be the basis for fixing profit margins. New markets, be they South Africa or quotations through the

Table 8.3: Annual Cost Components, Networking and Pricing Options for Nityanand Enterprises, Ichalkaranji

(Rs in million)

Sr. No.	Major Components of Cost	Variable Cost	Fixed Cost	Networking Options for the Enterprise
1.	Raw material	7.5		A yarn purchase network may be formed including this enterprise for bulk purchase of inputs.
2.	Sizing	0.486		About 20 of them must come together to establish and effectively utilise a sizing unit (Rs 80 lakh in terms of project cost).
3.	Brokerage to marketing agents	0.243		NSIC (Government orders and institutional orders) and Market Development Assistance (MDA) support (South Africa and other markets to be explored) on networked basis to reduce relevant risk in exploring the option as also reduce the cost of brokerage.
4.	Seconds (loss on sale)	0.121		
5.	Interest on credit purchase	0.243		Savings by establishing a purchase network for cash purchase is an option to reduce this cost.
6.	Weaving		2.851	The enterprise need consider establishment of own looms as it is confident of market demand. About 20 per cent of relevant costs may be saved. Alternatively, working as a network it may utilise looms on a long lease basis. Weaving operation will turn into a fixed cost from the current scenario of this component being a variable cost.

NSIC, differential pricing may be incorporated to penetrate such markets. The costing estimates, will obviously vary if all other options indicated in Table 8.3 are implemented.

In the local industrial co-operative estate, about 4,000 looms exist. MCGFS to convert tiny job workers to own input purchase operators and in some cases avoid credit purchase and informal borrowings is an option.

Options for Processing Enterprises

Avinash Dadaji is 'overall' incharge of a processing unit 'Dadaji Processors' with a turnover of Rs 50 million. The enterprise commenced operations in 1988 and pays excise duty of almost Rs 2.4 million. It is not fragmented! A 'loss' as many successful entrepreneurs will declare! However, these are necessary to access cheap institutional credit for upgradation of equipment. The enterprise finishes grey fabric largely in terms of mercerising-bleaching, dyeing and finishing. It caters largely to exporters and operates on job work basis. In initial years, the enterprise operated on the basis of 'hand process' prior to upgrading in terms of advanced equipment worth Rs 20 million and today utilises necessary working capital from a bank. The annual expenses of the enterprise is presented in Table 8.4.

A study revealed that the enterprise is a member of the western Maharashtra processing association and makes a margin on sales of (net) 20 per cent—a 'relatively' good performer. The main dyes procured as inputs are sulphur, reactive dyes, vat dyes and dispersed dyes. The chemicals sourced by the enterprise include acetic acid, soda ash, peroxide and finishing chemicals. The annual requirement of chemicals and dyes is about Rs 20 million in this processing unit. The unit processes grey cloth that is produced by powerloom weavers on job work basis for

Table 8.4: Annual Cost Components of Dadaji Processors, Ichalkaranji
(Rs in million)

<i>Major Cost Components</i>	<i>Cost</i>
Electricity	4
Fuel (wood and bagasse)	4
Dyes and chemicals (largely sourced from traders in Mumbai)	20
Wages	3.6
Misc. (Interest)	1.2

exporters and other value-added product manufacturers focusing on the domestic market. The enterprise is operating in a market of seasonal demand. The enterprise operates on full-capacity basis, that is, on a three-shift basis for over 300 days per annum. Sales, however, is down by about 50 per cent viz., minimum sales over August, September, October and peaks over March, April, May and June due to demand for school uniforms and in Gulf countries, etc. The enterprise processes raw material, chemicals and dyes based on orders received. Hence, inventory management incorporating principles of EOQ is difficult! A critical option for such enterprises, nevertheless, is to appropriately source inputs such as fuel and dyes and chemicals on networked basis. They may learn from the successful experience of sizing units in Ichalkaranji elaborated below.

Sizing Units at Ichalkaranji Powerloom Cluster: A Model Network Who May Do Better by Efficient Counselling

Sizing units at Ichalkaranji used to earlier source starch from local traders. Considerable cost reduction has been facilitated over the last two years by means of

procurement in bulk and negotiating commonly through the 'Ichalkaranji Sizing Co-operative Society Ltd.' There are 115 units in Ichalkaranji which are members of this co-operative. These units prepare warp beams on job-working basis. They are, thus, an important link (related enterprise) in the production of cloth. They are 'collectively' large-scale consumers of tapioca starch, maize starch and mutton tallow in particular.

Their combined requirements of starch are over 5,000 tonnes per year costing about Rs 60 million. This, they source directly from Salem in Tamil Nadu, (not from local traders) through their cooperative or association. The well-known cooperative 'Sago Serve' at Salem serves as their counterpart. The sizing units at Ichalkaranji, nevertheless, confront price cartelisation from Salem and scope for exploring better supplier sources exists. Even with custom duties (which are in themselves progressively being reduced) it may be possible to import at less cost from Thailand. The enterprises also utilise firewood and bagasse. These are progressively turning expensive and scarce, particularly, as supply is also dependent on government allocation. The enterprises jointly procure about Rs 125 million of firewood and bagasse. The coal firing option by commonly importing about 50,000 TPA coal from Australia, China or the UK may be explored by these enterprises. The NSICs support for common raw material sourcing and financing may be effectively tapped. Including ITPO and concerned embassies in India will also be useful for international sourcing of cost-effective inputs.

Suppliers will have to be informed of annual requirements and on purchase frequency, as also, will effective 'container cost' optimisation have to be analysed. An economic order quantity analysis upon identifying optimal volume of 'bulk-networked' purchase will also be useful. Further, imported coal could be a better option because of the bad experience of these entrepreneurs with domestic coal in terms of '20 per cent content being stone/ash'!

Productivity may be enhanced even while operating costs are reduced.

Mutton tallow import from Australia to meet the bulk and common annual requirement of about Rs 20 million may be considered simultaneously. The current cost structure of an enterprise with a turnover of about Rs 12 million in such sizing units is presented in the Table 8.5.

Table 8.5: Annual Costs and Margins of a Sample Sizing Unit at Ichalkaranji

(Rs in million)

<i>Major Components</i>	<i>Cost</i>
Fuel e.g., coal	2.5
Starch	3.0
Transport	0.5
Labour	1.8
Power	1.2
Misc. expenses (including interest)	1.0
Net profit margin on sales	15%

Table 8.5 indicates that ideal networked sourcing could help save costs considerably resulting in a more attractive cost structure for an enterprise.

Chapter 9

Revitalisation Plans: Caselets across Sectors

As part of a revitalisation plan, the strategic positioning of a small enterprise in a competitive environment (adapting Michael Porter's model on competitive strategy) may first be evaluated by analysing industrial structure. This is performed by evaluating the status of an enterprise vis-à-vis various factors such as barriers to entry to the industry, the strength of buyers and suppliers, and the extent of rivalry in the specific industry.

Entry barriers forestall growth of competing enterprises and thus, reduce competition levels. Enterprises may develop entry barriers by developing brand identity. The strength of an enterprise vis-à-vis its raw material and service providers lies on the volumes it demands. The strength of a firm with respect to its customers and consumers (also) rests on the switching costs of buyers and the price sensitivity of customers. The extent of rivalry in an industry is influenced, in turn, by market growth rates.

Industry structure determines profitability and sustainability of a small enterprise. A counsellor needs to explore means by which entry barriers may be raised and thus forestall competition; bargaining power of consumers and suppliers should be reduced; and rivalry should not undermine the profitability of an enterprise. For example, the bargaining power of suppliers may be reduced by the formation of hard networks of small enterprises for common bulk purchase. Rivalry undermining profits of all firms may be reduced by means of exploring options for non-price competition and so on. The factors influencing industry structure and counselling options will first have to be explored.

The strength of customers may be studied by exploring the following questions: Are customers concentrated or comprise a few major buyers? Are the products offered to the customers standard and undifferentiated? Will customers not have to face significant costs by switching from one seller to another? If the response to such questions is positive, the strength of customers is high. An action plan may be evolved along the following lines: Broadly, for a Rs 5 million turnover coir product enterprise in Alleppey which processes semi-finished mats and supplies them to exporters and traders in the region, a few major buyers—about 15—may exist. This customer category purchases all the enterprise's output. The products purchased by the customer groups (exporters or traders) are standard and undifferentiated. Also, both customer groups would face no switching costs (either in terms of quality or price) by shifting to another supplier. Hence, customer strength is very high. Marketing efforts targeting both customer categories need to lay emphasis on better credit or price discount strategies alone. Cost reduction options on a consortium mode may be one viable option to efficiently develop sales and sustainably revitalise performance.

The strength of input suppliers may be studied by exploring the following questions: Are there no viable substitutes to the products provided by the supplier? Is the supplier group dominated by a few enterprises? Would significant switching costs be incurred in changing from one supplier to another? If the response is positive on these issues, the strength of the supplier category is high. With regard to the supplier group, two major inputs are sourced by a jute product manufacturer in Kolkata: natural fibres, and chemicals and dyes. In the first supplier category, manufacturers are invariably tiny in size, numerous and weak in all the above areas. However, with regard to chemicals and dyes, local traders are small in number and their bargaining strength high on the first three issues. Hence, a counsellor may evaluate the option of forming a consortium for the purchase of chemicals and dyes and identify better sources—perhaps directly from Ahmedabad.

The strength of barriers to entry for new firms may be studied exploring the following questions: Are firms in the industry not highly differentiated? Is brand identification and customer loyalty low? Are capital requirements for entry into the industry low? Do firms lack proprietary technology, skill and/or personnel that are not readily available to new entrants? Are there too many distribution channels? If the response is positive on these issues, the strength of the supplier category is high. An action plan may be evolved that takes into account the fact that entry barriers in most 'traditional' sectors are low. For merchant exporters or integrated manufacturers and exporters in traditional sectors, brand building may be the only barrier to new competition.

The extent of competition may be studied exploring the following questions: Is growth in the industry relatively slow? Are products highly differentiated from one firm to another in the industry? Are the numbers of firms in the industry high? Are fixed costs in the industry high? If the

response is positive on these issues, competition is high. An action plan may be evolved along the following lines: For a manufacturer in most traditional sectors, the level of unhealthy competition faced is likely to be high. Cost-based (rather than differentiation- or innovation-based) competition is likely to prevail. This may be resolved by an entrepreneur striving to network among like-minded entrepreneurs and with private and public service providers to tap new buyers (new geographical markets or market segments), identifying new value-added products or, intensively pursuing productivity/design/quality related innovation/upgradation.

An analysis of these four aspects will, therefore, help evolve necessary revitalisation options for small enterprises.

Analysis of the Capital and Cost Structure of an Enterprise—Illustrations

An analysis of a small enterprise will help in formulating decisions on its cost and financial structure. It will, therefore, help in making decisions on the risk orientation of an enterprise. Consider an adverse environment with falling demand and increased competition. An analysis of the cost structure of an enterprise (RMG Machine Tools) reveals a thrust on fixed costs. This implies an aggressive or relatively risky cost structure in an adverse environment. Break-even levels highlight the level of sales at which profit before tax (PBT) is zero. Information available on RMG Machine Tools, Bangalore for the year 2000–01 is given in Table 9.1.

Break-even sales may be estimated by using the formula: $\text{fixed costs}/\text{sales realisation} - \text{variable cost}$. Break-even sales is about 49.3 per cent of current sales.

Table 9.1: RMG Machine Tools, Bangalore—
Data on Cost, Output and Profit

<i>Cost—Output—Profit</i>	<i>(Rs in million)</i>
Sales	5,000,000
Less: Variable cost	4,250,000
Contribution	750,000
Less: Fixed costs	370,000
Profit before Tax (PBT)	380,000

Risk Analysis of the Enterprise

Risk is estimated in terms of possible variability in profit. The variability in profits arises primarily because of variability in sales (volumes or margins or both). The impact on PBT of RMG Machine Tools, if sales drop from its current level, indicates a fall greater than the fall in sales. This is the Degree of Total Leverage (DTL) and measures the risk arising out of profit sensitivity to sales.

$$\begin{aligned} \text{DTL} &= \frac{\text{Contribution}}{\text{PBT}} = \frac{750,000}{380,000} \\ &= 1.97 \text{ (approximately)} \end{aligned}$$

This risk includes: (i) the degree of operating leverage (DOL) arising from the structure of operating costs (variable costs that vary with output and fixed costs that do not) of the enterprise, (ii) the degree of financial leverage (DFL) arising from the financial structure of the firm. This has reference to loan as against equity (promoters' contribution) structure in an enterprise.

The degree of operating leverage (DOL) measures the percentage change in PBIT for a percentage change in sales as shown on the following page.

$$\begin{aligned} \text{DOL} &= \frac{\text{Contribution}}{\text{PBIT}} = \frac{750,000}{680,000} \\ &= 1.10 \text{ (approximately)} \end{aligned}$$

The degree of financial leverage (DFL), on the other hand, measures the percentage change in PBT for a percentage change in PBIT. An enterprise that has taken more of institutional finance vis-à-vis own equity will have a high DFL.

$$\begin{aligned} \text{DFL} &= \frac{\text{PBIT}}{\text{PBT}} = \frac{680,000}{380,000} \\ &= 1.78 \text{ (approximately)} \end{aligned}$$

The degree of total leverage (DTL) is the product of DOL and DFL. Fixed costs in operations cause a 1 per cent change in sales to lead to more than 1 per cent change in PBIT. Similarly, 1 per cent change in PBIT causes profits to change by greater than 1 per cent. Fixed costs leverage the impact of changes in sales on profits. A high DTL is fine if there is scope to increase sales and market growth is high in an industry. If not, the same could be harmful to the enterprise as the fall in PBT will be 1.97 per cent (DTL) for every 1 per cent fall in sales. Structuring an enterprise's finance and costs is, thus, important to increase its returns or reduce risk.

The lessons for a counsellor in terms of exploring subcontractation options or innovative financing options for small enterprises to reduce the interest burden, which is a fixed cost, exist. Further, depending on the risk-return trade-off and potential of an enterprise, greater debt financing may be availed of and/or variable costs may be selectively converted into fixed costs as a part of the revitalisation plan of an enterprise.

The case of Malampuzha Exporters, a merchant exporter of handloom products in Kannur, elaborates on the options available.

The exporter has a turnover of about Rs 30 million. He supplies tablemats and curtains to large chain stores as well as speciality outlets abroad. His investment in fixed assets is largely on account of a dyeing unit costing about Rs 800,000. The cost structure of the enterprise for the year (2001–02), is presented in Table 9.2.

Table 9.2: Cost Structure (2001–02) of Malampuzha Exporters, Kannur

(Rs in million)

Sr. No.	Major Components of Annual Costs of Production	Variable Cost	Fixed Cost
1.	Raw material (yarn)	18.0	
2.	Dyes and chemicals	3.0	
3.	Job charges	4.0	
4.	Salary		0.7
5.	Marketing		1.5
6.	Interest cost (8 per cent on about Rs 50 lakh)	0.4	
	Total	25.4	2.2

Profit before tax for the enterprise is Rs 2.4 million. Adding on DEPB @ about 5 per cent of export turnover, the total profit before tax is about Rs 3.9 million. Profit before interest and tax (PBIT) works out to Rs 4.3 million. The effective operating leverage for the enterprise works out to Contribution/PBIT or 6.1 million over Rs 4.3 million. The financial leverage works out to PBIT/PBT or 4.3 over 3.9. Therefore, the ratios works out to 1.41 and 1.10 respectively. The degrees of total leverage is, therefore, 1.55 (currently). Certain modifications in operations would yield a revised cost structure.

The working capital cycle of the enterprise is about three months. With regard to raw material yarn, the enterprise buys about Rs 4.5 million every rotation in cash, largely from local traders. The enterprise may work as a hard network for purchase on a consortium basis of different yarn varieties from a single or few mills in terms of about Rs 20 million every quarter. This may require the formation of a consortium or network of five similar enterprises. A bulk discount of 3–5 per cent may be realised for cash and bulk purchase. Similarly, such a consortium could purchase about Rs 4 million worth of chemicals and dyes every rotation. This could help yield a minimum 15 per cent as quantity discount in the price of chemicals. In fact, a commitment for purchase by means of a post-dated cheque (with bank guarantee) could help realise a higher discount of close to 20 per cent. The enterprise could also save the Rs 200,000 that it pays as income tax if it enhances its working capital limit from Rs 5 million to Rs 7.5 million. In fact, even with this increase, it will continue deploying a part of own funds in rotation. As the enterprise is confident of sales and the selling price the following year, it could also convert its job working or labour charges into a fixed cost.

The concomitant revised cost structure of the enterprise is presented in Table 9.3.

Profit before tax of the enterprise could almost double to about Rs 6.4 million. Profit after tax will also increase. Total cost has fallen due to conversion of dyes and chemicals and labour charges into fixed costs. Income tax is also avoided by increasing limits and not utilising equity excessively to finance operations. The new operating leverage (Contribution/EBIT), or 13.5 million over Rs 7 million equals 1.92 and the new financial leverage is $(7.0/6.4)$ or 1.09. The new total or combined leverage works out to 2.1. Hence, 'profitability' of the business has also increased from the earlier scenario! Cost reduction in the international marketing front can be facilitated by

Table 9.3: Revised Cost Structure of Malampuzha Exporters, Kannur (2002–03, Projected) *(Rs in million)*

Sr. No.	Major Components of Annual Costs of Production	Variable Cost	Fixed Cost
1.	Raw material (yarn)	17.4	
2.	Dyes and chemicals		2.2
3.	Job charges		3.2
4.	Salary		0.7
5.	Marketing		1.0
6.	Interest cost (8 per cent on about Rs 75 lakh)	0.6	
	Total	18.0	7.1

effectively utilising the Market Development Assistance (MDA) scheme of the ministry of commerce, and the more recent, DCSSI scheme, if necessary. Airfare subsidy of up to 90 per cent is offered for travel for trade fair participation and 'study' tours. Simple 'freeware' packages and modes of telephoning through the Internet could help substantially save on high marketing communication costs.

Options for Development and Evaluating Plans

The development plan could involve: (a) Tapping new markets for the products offered by an enterprise. Small exporters making leather products in Chennai, for example, have been focusing on Latin American markets in recent years as emerging markets for their products. Earlier, the thrust was on European Union and North American markets; (b) Exploring introducing new products targeted at either new or existing markets. Coir entrepreneurs may focus on developing value-added products. 'Geo-Textiles' is a case in point; (c) Exploiting

opportunities by introducing completely new products in new markets. Coir pith is a new product being progressively offered by small coir product manufacturers to a new market segment—the horticulture sector. Earlier, the thrust was on the household furnishing segment of mats and mattings; and (d) Bringing about an efficient change in business management and systems.

When the option for enterprise development is understood, the Strengths-Weaknesses-Opportunities-Threats (SWOT) analysis of an enterprise needs to be pursued. Business skills and assets of an enterprise and promoter contribute to strengths. Strengths, however, need to be relevant to the circumstance of a particular enterprise. For a small entrepreneur manufacturing equipment for rubber product manufacturers in Kottayam, after sales service network is vital. Therefore, it is essential to identify key requirements that affect a plan and relate the same with the strengths and weaknesses of an enterprise. Opportunities refer to potential favourable external factors. International demand may be rapidly growing by virtue of rising levels of per capita income encouraging more demand for environmental friendly products. These may include rubber products as against plastic products. Threats refer to external problems. For instance, the imminent introduction of a substitute product at a lower cost could be a threat. Jute or sisal mattings, as a substitute for coir matting is a relevant example. Opportunities may also result from reduced tariff barriers against imports of cotton hosiery products in importing countries with the onset of the WTO regime. Trade liberalisation and the creation of a free market present both threats and opportunities. Deregulation opens up markets but also intensifies competition among product producer countries. Some small exporters in the leather industry in Chennai and the woollen hosiery sector in Ludhiana did not have the resources to meet large export orders. They secured orders by offering reduced prices but found that they could not

meet delivery schedules due to resource limitations in terms of equipment and working capital. Hence, strength and opportunity need to be carefully assessed; otherwise the image of an enterprise may be irreparably damaged. Counsellors for small businesses should study the plans of financial institutions, policy-making and implementing bodies, suppliers or competitors and incorporate them into the plans for the future.

Parameters for Studying Plans and Profiling Them

Any plan needs to be analysed from the financial angle to establish its feasibility using parameters such as return on capital employed and break-even (risk) levels. There are also non-financial parameters to be considered. The relevant questions may include: How difficult is it to acquire and implant technology? Can requisite managerial skills be out-sourced or hired, if necessary? Are there any substitutes or competing products for the project's output? What is the basis of competition? Is it cost or real differentiation (quality, design, delivery based)? What is the competitive advantage that could support the plan? Are there any constraints in accessing raw material? Are they appropriately sourced? What are the means to reduce costs on this front? Are there any government controls over the price of a project's output and the raw materials? Earlier, there had been a minimum purchase and export price in the coir industry, for example. How can the plan take maximum advantage of policy support and incentives available?

A performance and potential analysis studies the internal and external factors that influence an enterprise's plans. A detailed assessment of a plan is required. An indicative profile as presented in Figure 9.1 may also be prepared.

Figure 9.1: Indicative Profile for Performance and Potential Analysis

<i>Situation</i> → <i>Resources</i> ↓	<i>Existing</i>	<i>Plan</i>
<i>Physical resources:</i> <ul style="list-style-type: none"> • Physical assets (land, building and equipment) • Manpower 		
<i>Financial resources:</i> <ul style="list-style-type: none"> • Credit from raw material suppliers • Working capital facility • Investible surplus and equity and collateral potential 		
<i>Management:</i> <ul style="list-style-type: none"> • Production function • Finance function • Marketing function 		

Performance and Potential Analysis and Revitalisation Plans: Caselets

A revitalisation plan may involve incorporation of essential management tools in decision-making. This section presents caselets in this context both at the enterprise and sectoral levels. Consider the following case related to costing and pricing intertwined with market segmentation. Bhattacharya Industries is a jute product-manufacturing unit in Kolkata and was established in 1994. The unit largely employs own funds (reserves). The promoter has a family background of trading in yarn before moving into manufacturing. The unit uses five looms. Land and

building are free of charge and may be offered as collateral for institutional financing, if necessary. Production equals 350,000 sq m of jute mattings (two shift working for 300 days a year). The enterprise is operating at full capacity. The structure of costs and break-even of the enterprise is presented in Table 9.4.

A revitalisation plan from the year 2002–03 onwards may include utilisation of a few simple but

Table 9.4: Cost Structure Analysis of Bhattacharya Industries, Kolkata—Scenario in 2001–02

<i>Sr. No.</i>	<i>Major Costs</i>	<i>Variable Cost</i>	<i>Fixed Cost</i>
1.	Raw material cost	15,700,000	
2.	Dyeing charges	2,000,000	
3.	Power charges	450,000	50,000
4.	Salary to workers		3,800,000
5.	Incentives to workers	1,000,000	
6.	Salary to admn. and support staff		2,100,000
7.	Carriage outwards	2,000,000	
8.	Wholesalers commission on sale of mats	5,000,000	
9.	Damages and rejection	300,000	
10.	Pension contribution, ESI, PF etc.		1,200,000
11.	Repair and maintenance	400,000	
12.	Overhead expenses related to communication etc.		200,000
13.	Depreciation		700,000
14.	Selling expenses (special discount necessary due to intense competition)	1,200,000	
	Total	28,050,000	8,050,000

Table 9.5: Break-even Levels of Bhattacharya Industries, Kolkata

Selling price	Rs 115 per sq m
Capacity	350,000 sq m
Max. potential sales revenue	Rs 40.2 million
Total contribution	Rs 12.2 million (approximately)
Break-even level of activity	At 70 per cent capacity

necessary management tools. Break-even, at relaxed estimates is achieved only at a very high level of operation (Table 9.5). Small fluctuations in output or fall in selling prices may affect performance. The business risk is very high. Variable cost per unit of output equals Rs 80 (approximately). The unit could, therefore, purchase two more looms at a cost of Rs 7 million. Interest cost if formal outside finances are used may be about Rs 1 million per annum. The unit could, therefore, produce 150,000 sq m additionally under this expansion programme. This expanded volume could be sold not through existing channels, which is believed to be saturated but, exported @ Rs 100/sq m. This is approximately the rate at which competitors export their products.

Hence, profit on sale of 350,000 sq m of mats in the domestic market equals Rs 3,850,000. Profit on sale of 150,000 sq m of exported mats is Rs $20 \times 150,000$ equals Rs 3 million. Net cash profit after deducting interest charge and repayment of principal on enhanced investment equals about Rs 1 million (approximately). If own funds are used, net cash profit is Rs 30 million (excluding opportunity cost). Hence, total cash profit of the business increases by about 35 per cent if debt financed and 70 per cent if equity financed. The option highlighted above would help increase profits and competitive orientation of the unit. The analysis indicates scope for professional management inputs in small enterprises.

The following section provides further examples on modes of conduct of a performance analysis and preparation of a potential revitalisation plan. As the objective is to present the analytical modes in brief, the analysis involves broad estimation of relevant parameters and is merely indicative of the methodology and options for interventions by a business counsellor.

Performance Analysis of a Small Dyes Manufacturing Enterprise—Select 'Ratiotic' Tools

Shah Dyes and Intermediates is a small 'reactive dye' manufacturing enterprise. The 'de-facto' income or profit and loss statement and balance sheet estimates were formatted as presented in Tables 9.6 and 9.7. The relevant data for the previous two years was considered for performance analysis with regard to financial, marketing and production management as a precursor to the conduct of a detailed analysis.

An analysis of trend performance of the enterprise indicates that on the finance front, net profit margin viz., EBIT/Sales was 5 per cent in 1999–2000, and has marginally increased in 2000–01. Return on capital employed (EBIT/CE) has fallen from 15 per cent to about 12 per cent. With regard to liquidity ratios, both current ratio (CA/CL) and the quick ratio (CA—Stock/CL) have remained stagnant. The enterprise is relatively comfortable on the liquidity front. Nevertheless, the problem of falling returns may be ascribed to the marketing and the production front. On the marketing and production front, the debtor turnover ratio (credit sales/debtors) has fallen and so has the stock turnover ratio. This indicates that increase in investment (capital employed) has been utilised (more) to fund credit and carry high levels of stock affecting relative profitability over 1999–2000 to 2000–01. Target areas for intervention

Table 9.6: Developed Profit and Loss Statement of Shah Dyes and Intermediates (Analytical Format—approximated values)

(Rs in thousand)

<i>Reference Year</i>	<i>1999–2000</i>	<i>2000–01</i>
Cash sales	84	8960
Credit sales	756	957
Total sales	840	1047
Cost of sales (direct cost)	660	834
Gross profit margin	179	212
(Indirect) expenses on:		
Warehouse (storage)	36	39
Transportation	16	28
Administration	84	46
Interest on term loan		56

Table 9.7: Developed Balance Sheet Figures (Analytical Format)

(Rs in thousand)

Fixed assets (FA) less depreciation	84	112
Current assets:		
Stock	168	263.2
Debtors	140	229.6
Cash	28	19.6
Total current assets	336	512.4
Current liabilities (sundry debtors)	140	212.8
Net Current Assets (NCA)	196	299.6
Capital employed (FA + NCA)	280	411.6
Promoters' contribution	210	210
Unsecured loan (interest free)	70	117.6
Soft term loan (for additional looms)		84
	280	411.6

on the finance, marketing and production front have been, therefore, identified.

Performance and Potential Brief of a Small Job Working Manufacturer

Aradhana Enterprises manufactures rubber mats. The enterprise makes semi-finished rubber mats and polypropylene mats and supplies them to exporters. In 2000–01, major enterprise cost structure components were as follows:

(Rs in thousand)

Sr. No.	Major Costs	Variable Cost	Fixed Cost
1.	Labour	450	
2.	Rent	50	
3.	Opportunity cost (interest on own working capital)	2.5	
4.	Salary		60
	Total	502.5	60

The enterprise has effectively operated on a single shift basis for 250 days in the year. The enterprise deploys own funds as working capital—about Rs 25,000. This amount is permanently blocked in business operations for payment of wages/salaries. The operating cycle is two weeks (largely work-in-process period). The enterprise pursues operations purely on job work basis and has no fixed assets of its own but rents out factory and equipment other small manufacturers. The enterprise had a sales realisation of Rs 800,000 in the year 2000–01. The break-even level of activity is therefore at about 20 per cent capacity.

The enterprise made a profit of Rs 240,000. It employs Rs 25,000 of own funds in the business. The return on capital employed viz., profit over capital employed is, therefore, about 1000 per cent. Very high returns are secured by this job-working enterprise, which works with little or no fixed assets. The liquidity of the enterprise is also high. However, as part of potential revival plan, the enterprise could go in for formal working capital finance perhaps on a networked MCGF mode and purchase (partly) own raw material and also offer credit period of, say, two weeks to customers. This could help boost margins and help secure more orders, particularly from smaller exporters who do not prefer job workers. The enterprise's product-mix for the year 2000–01 is presented in Table 9.8.

Table 9.8: Aradhana Enterprises, Kottayam, Kerala—
Mat Manufacturers
(Rs in thousand)

Sr. No.	Products	Sales Realisation	Variable Cost (Approx.)
1.	Rubber mats	300	265
2.	Latex backed mats	200	13
3.	Polypropylene mats	100	80
	Total	600	475

The total turnover included other products whose margins are less than 10 per cent and variable costs in manufacture are very high. As an ideal marketing strategy, the enterprise could offer a discount of up to 10 per cent with regard to rubber mat manufacture to enhance orders and increase capacity utilisation, and hence, profits. Many small enterprises in the rubber cluster in Kottayam, Kerala have invested in their own land, building and equipment up to Rs 1 million, for instance, with an average of 15–20 per cent margins on turnover for their

largely job worked operation. They fail to repay interest and principal on term loans, particularly because of excessive competition, which has affected capacity utilisation. Leveraging on such fixed costs would have been optimal if they were working on their own working capital and had sufficient market demand to effectively utilise assets. Unfortunately, they suffer from inadequate levels of both and hence fail!

Performance and Potential Revitalisation Plan Analysis of a Coir Mat and Mattings Processor

Enterprise Profile and Industry Structure Analysis

Jerome Coir Mats and Mattings Processors commenced operations in 1995 with an investment of about Rs 3.5 million on building, equipment and land. The enterprise is a partnership concern and has experienced growth rates varying from 5–10 per cent per annum in the last decade.

There has been a sustained increase in the number of customers over the years and the company has managed to repay all term loan-related liabilities. The enterprise is involved in processing semi-processed mats. The enterprise deals with a few major buyers—about 10 in number. These include small and medium exporters and domestic market traders. The products offered by the enterprise are standard and undifferentiated. The customers will face no switching costs if they drop them for other suppliers. Hence, the enterprise is very weak on this front. The margins earned by the enterprise and terms of sale are invariably decided by the customers. The options to reduce cost need to be explored to maintain and enhance the

Table 9.9: Operations on an Annual Basis of Jerome Coir Mats and Matting Processors

		<i>Current Scenario: 2001–02 (Actual Capacity Utilisation: One Shift of 8 hrs at Full Capacity for 250 days/year: In Rs million)</i>		<i>'Optimal' Scenario: Installed Capacity Utilisation on the Basis of Current Management Style and Product and Market Mix 2001–02 (Installed Capacity: Three Shifts of 8 hrs for 250 days/ year: Rs in million)</i>	
<i>Sr. No.</i>		<i>Variable Cost</i>	<i>Fixed Cost</i>	<i>Variable Cost</i>	<i>Fixed Cost</i>
1.	Raw material (Fibre and chemicals/ dyestuff)	3.2		9.3	
2.	Wages	0.6		1.7	
3.	Salary (including Administrators/ managers salary, security)		0.25		0.25
4.	Power	0.15	0.02	0.435	0.02
5.	Interest cost (Working capital) {including informal finance @ 3% per month} finance as a variable cost = 1.3 lakh	0.13 + 0.037		0.39 + 0.111	
6.	Depreciation (taken @ 10% p.a. straight line method)		0.25		0.25
	Total	4.117	0.520	11.936	0.52

customer base. Further, the ideal credit and discount strategies need to be evolved to stay ahead of the competition.

A study of the suppliers indicates that with regard to semi-processed mats, the enterprise sources from hundreds of very small units and, therefore, has a good bargaining strength. However, its bargaining strength with regard to rubber or latex and chemicals and dyes is poor as these suppliers are large in size. Consortium-based purchase of these inputs, including ideal sourcing of chemicals and dyes from Ahmedabad, may prove necessary. The entry barriers to this segment of the industry are low as products are only cost differentiated and the capital requirement is also low. Any new enterprise can create distribution channels and acquire the relevant skills. Further, competition in the industry is intense and cost based. The revitalisation plan should focus on identifying new market segments, manufacture of value-added products and product-led diversification.

Structure of Costs in the Enterprise

The structure of costs in the enterprise is presented in two contexts (Table 9.9)—the current 'performance' scenario (for the year 2001–02: Actual capacity utilisation with prevalent product and market mix), and an 'optimal' scenario given current management style (for the year 2001–02: Installed capacity with prevalent market and product mix). Optimal scenario with ideal product mix, is not considered at this stage of study. The enterprise has repaid all term loans and is currently operating with a working capital facility of Rs 250,000. Interest cost is about 15 per cent per annum. The enterprise had a turnover of Rs 5 million in 2000–01.

Performance Analysis: Introduction

In an 'optimal' scenario operating at full capacity, the projections have taken into account the fact that raw material cost are expected to fall by 3 per cent and labour charges by 5 per cent. Power costs are also expected to fall by 3 per cent. Further, working capital required (Net Current Assets) for optimal scenario is also based on current management style followed by the promoter and is, hence, expected to rise proportionately in the optimal 'capacity utilisation' scenario. Sales performance at the optimal 'capacity utilisation' scenario is expected to also rise proportionately with the increase in capacity utilisation. The break-even level of activity of the enterprise is estimated at 58.8 per cent.

Total profit before tax of the unit in current circumstance equals Rs 5 million – 41.17 – 0.52 or Rs 310,000. The promoter believes the relative cost structure of the enterprise remained broadly the same over the past few years. Sales turnover has been increasing at an average rate of 10 per cent per year. The break-even level of activity broadly is at about 58.8 per cent or Rs 2.9 million in terms of current sales.

An analysis of the perceived 'optimal' scenario given the current product mix at full capacity utilisation of three shifts for 250 days a year yields the break-even level of activity of the enterprise

$$\begin{aligned} \text{Break-even level of activity} &= \left(\frac{0.52}{15 - 11.936} \right) \times 100 \\ &= 16.9\% \text{ capacity} \end{aligned}$$

However, achieving an 'optimal' profit level may not be realisable given the current marketing style

(discount and credit strategies), finance (absence of ideal working capital facility and resort to costly informal finance) and, production management (non-utilisation of enterprise level or consortium based EOQ principles in the purchase front). The benefits of 'hard' networking options with other small enterprises are also absent, particularly on the raw material purchase front.

Performance Analysis of the Enterprise

Financial Front

Profitability: In order to analyse profitability in simple and realistic terms, capital employed is treated as equal to fixed assets (market value) + net working capital. The enterprise has invested Rs 1 million in land, Rs 900,000 on equipment and Rs 600,000 on buildings. This aggregates to about Rs 2.5 million. As on March 31, 2001, the enterprise 'de-facto' had about Rs 612,000 as Net Current Assets or Net Working Capital position. Total CE was therefore = Rs 3.11 million.

$$\text{Therefore, effective ROI} = \frac{\text{EBIT}}{\text{CE}} = 17\% \text{ (approx.)}$$

Interest has been about Rs 180,000 and taxes (actually paid) = Rs 40,000

$$\text{Effective ROE} = \frac{\text{EBT}}{\text{CE}} = 11.66\%$$

The profitability of the enterprise is reasonably high. However, effective performance improvement and revitalisation warrants interventions on various aspects on the management and networking fronts.

Liquidity: The enterprise liquidity position or current ratio viz. current assets (stock + cash + sundry debtors) over current liability (largely sundry creditors) position as on 31 March, in 2000–01 was about nine. The enterprise is very liquid in terms of performance and ability to meet maturing obligations in the short term. The quick ratio or quick assets (cash + sundry debtors) over current liabilities also worked out to 1.5 approximately, substantiating this impression. However, excessive stocking of inventory is indicated with relevant costs. Hence, potential profitability is affected.

Working capital estimation: The stocking period and cash locked-in period over various components of the operating cycle of the enterprise is estimated as follows: Raw material (15 days), sundry debtors (35 days), work in progress (about 4 days), finished goods (about 10 days) and sundry creditors (7 days) viz., cash locked-in period is for 57 days or about two months. Taking raw material cost of Rs 3.2 million per annum, the relevant cost works out to Rs 530,000. Further, about one month of other expenses works out to about Rs 82,000. The total requirement, therefore, works out to about Rs 612,000. The difference of working capital limits viz. Rs 250,000 and requirement is about Rs 362,000 per month that the enterprise borrows @ 3 per cent per month from 'informal sources'. The cost of this being about Rs 130,000 per annum. This aspect also affects profits.

Financial leveraging: The enterprise has been making Rs 363,000 as profit before tax. But Rs 54,000 is paid in spite of 'dressed balance-sheets' by the promoter as personal income tax. The leverage of the enterprise in terms of viz., contribution over EBIT (informal finance related interest is not considered for this purpose) equals Rs 883,000 over Rs 400,000 or about Rs 220,000. The enterprise has been availing of the benefits of financial leveraging but not to the desired extent as it has been resorting to costly informal borrowings (as a risk-reducing

option) and paying relatively higher levels of tax. Effective cost of capital is high. Profits and profitability orientation are, therefore, lowered.

Marketing Front

Pricing modes: The enterprise currently adopts a mode of competitor-based pricing. Elementary tools such as marginal cost-based pricing and contribution analysis based pricing (discount) and marketing strategy (discount vs. credit) are not adopted. This affects capacity utilisation.

Product and market mix analysis—Contribution analysis: The product and market mix of the enterprise for 2000–01 is as follows (Approx. figures in Rs million); Fixed costs are about Rs 520,000:

Table 9.10: Product and Market Mix on Annual Basis

(Rs in million)

<i>Product Mix</i>	<i>Output</i>	<i>Selling Price (Rs) (Average)</i>	<i>Variable Cost (Rs)</i>	<i>Total Sales Realisation</i>	<i>Total Variable Cost</i>
Full rubber	14,285	35	23	0.5	0.328
Full coir mats	53,333	75	64	4	3.413
Rubberised (latex backed) coir mats	4,348	115	86.5	0.5	4.117 (approx.)

The sales margin regardless of whether the promoter sells to exporters or to domestic market traders (their major customers) remains the same. These three products account for the bulk of turnover of the enterprise. The major marketing strategy thrust of the enterprise has

been to offer competitive credit terms, regardless of the product considered. Discount offers are made on the basis of competitor-based pricing, but remain largely as per average selling price indicated in the Table 9.10 presented above.

Discount versus credit options of the enterprise: Of the Rs 1.8 million turnover, the promoter believes that all output has been sold on credit for a 35-day period. Out of the total working capital requirement, this 35-day period cost of working capital is at high levels. It is about 60 per cent of total current assets of the enterprise necessitating about Rs 350,000 to be locked up here. Annual cost (assuming even formal finance rates of 15 per cent p.a.) is about Rs 50,000. Considering the fact that the promoter often resorts to 'informal' borrowings, the cost is over Rs 100,000.

Marginal cost-based pricing: The promoter adopts a strategy of competitor-based pricing and goes by market trends. Marginal cost-based pricing modes, perhaps after break-even level of activity is achieved, are ignored.

Production Front

Purchase of raw material is based on expected or confirmed demand for output by customers. Neither Economic Order Quantity (EOQ) of purchase modes nor optimal purchase levels on a consortium mode, for example, is considered. These two aspects could help save on production cost if some confirmation and planning on orders are made. Purchase on a consortium mode and utilisation on the basis of enterprise requirement would 'in effect' reduce ordering costs. EOQ purchase would in effect reduce carrying cost at the enterprise level.

Potential Analysis and Revitalisation Plan of the Enterprise

Finance Front

Profitability, working capital and leveraging: The return on equity of the promoter may be enhanced by targeting two aspects on the financial management front. Employing costly informal finance in business and paying a high level of tax on profits/net incomes. EBT/CE may be enhanced by enhancing formal working capital limits to about Rs 610,000. Further this will also help him avoid paying tax at current levels of operations. The revised cost structure of the enterprise, financial leveraging and net profits will be as follows:

(Rs in million)

Sr. No.		Variable Cost	Fixed Cost
1.	Raw material	3.2	
2.	Wages	0.6	
3.	Salary		0.25
4.	Power	0.15	0.02
5.	Interest cost (Rs 6.12 lakh WC @ 15% p.a.)	0.091	
6.	Depreciation		0.25
		4.04	0.52

- By going in for enhanced limits, the enterprise will reduce business risk viz., break- even level of activity is at 55.3 per cent or at about Rs 2.76 million of sales.

It effectively reduces cost of production (cost of capital) by Rs 75,000. It also removes the tax liability of

the enterprise effectively as formal interest cost is enhanced by about Rs 54,000. The net cost savings to the enterprise is, therefore, about Rs 129,000 by this revitalisation plan on the finance front.

Therefore, cost reduction and profitability orientation are both facilitated by the plan. The enterprise has the ability to offer increased collateral necessary for enhancing limits. In the absence of which an MCGF sort of option may be explored on a 'consortium basis'. The credit guarantee scheme of SIDBI may also be considered. Purchase of latex and dyes and chemicals on a consortium mode by ideally sourcing them will also contribute to reducing costs at the enterprise level. This cost reduction may be reflected on the selling price of products as to enhance capacity utilisation.

The following sub-section elaborates:

Marketing Front

The option of employing different pricing modes upon contribution analysis and on the basis of marginal costs of operations exist:

- The enterprise could offer a discount of about 10 per cent on rubberised coir mats and full rubber mats, which yields highest contribution. Even then, contribution from this product line would be higher than that of the other two products. This discount stratagem could help increase the rupee turnover and capacity utilisation of the enterprise.

- The promoter may decide on the optimal discount versus credit stratagem to increase capacity utilisation depending on market response. In fact, if for increased turnover he offers discount of 10 per cent for bulk customers of, say, over 4,000 rubberised coir mats alone, he may avoid seeking enhanced working capital limits and relevant cost of capital as part of revitalisation plan to fund credit sale. A cost-benefit analysis of discount versus credit options have to be progressively made over implementation of the plan depending on market preference and response.
- On a simple, marginal cost-based pricing mode, the promoter may target tripling of capacity utilisation by offering a discount of 10 per cent on all product lines once he achieves (revised cost structure) break-even sales of Rs 2.76 million. He could enhance capacity utilisation. This is yet another option he may consider to enhance output.

Production Front

As a part of the revitalisation plan, the promoter is of the belief that purchasing on the basis of economic order quantity would not be appropriate as he currently depends on orders for types of mats to be purchased. Orders and demand may vary every few months. However, he could certainly purchase chemicals and dyes on an EOQ basis. His requirement may be less than Rs 100,000 a year. He could, nevertheless, network with a few other manufacturers like himself and purchase chemicals of up to Rs 1.5 million per annum from suppliers in Ahmedabad. This could enable him to reduce relevant costs by 15–20 per cent.

Revitalisation of Enterprises across a Sector: Caselets

Revitalisation of enterprises in a sector that is affected by various internal and external problems, essentially requires stratifying enterprises in the sector perhaps along the supply chain and on the basis of other typologies such as export orientation and size. The caselets of enterprises in the handloom saree sector 'clustered' in Pochampally near Hyderabad and in the coir product sector concentrated at Alleppey, Kerala serve as illustrations.

Products from the handloom enterprises in Pochampally essentially comprise silk sarees targeting the domestic market. Curtains, scarves and other products are also made either from silk or cotton but in negligible quantities. Master weavers who are effectively traders produce the product almost exclusively on job-work basis from small household units having about four or more looms each. Such household enterprises secure raw material yarn on credit from master weavers. They, however, invariably purchase chemicals and dyes on their own from local suppliers for an operating cycle of about 45 days, because the minimum warping 'size' is for eight sarees or about 45 days on single shift basis inclusive of about six days off as weekends. The requirements of chemicals and dyes for this volume of activity of eight sarees are 400 gm of colour dyes costing about Rs 400, eight cakes of soap costing Rs 12, soda and sulphur of Rs 12 and Rs 50 respectively. Other requirements are acetic acid and wood for Rs 14 and Rs 200 respectively and thread for Rs 240. The total cost of dyes and chemicals, hence, works out to about Rs 928. Almost two family members work on a loom on an average in a four-loom household. The minimum maintenance cost of this labour is about Rs 3,000 for the 45 day-period. This is a fixed cost. The variable cost of

such a job-working weaver is, therefore, Rs 928 on a single shift working basis over the operating cycle of such a household unit. The fixed cost per operating cycle of such an enterprise is Rs 3,000. This is in terms of maintenance of total six persons for a period of 45 days. Net sales realisation upon reimbursement of chemical costs work out to about Rs 1,500 per loom or Rs 6,000 for four looms. The indicative break-even level of activity is, therefore, $(3,000)/(6,000 - 928)$ or at about 60 per cent of installed capacity (on a single shift basis) or at sales of about Rs 3,450. On a double shift basis, the break-even level works out to 30 per cent. They buy chemicals and dyes themselves appropriately and as required in small volumes. Merchant traders and master weavers do not want to assume the work of dispensing small volumes of chemicals and dyes. Nor do societies in the region. The outsourcers implicitly reimburse such cost upon completion of an order rather than supplying chemicals and dyes material. In fact, the advantage of bulk (and ideally sourced) purchase of this raw material is lost to both master weavers and household weavers! In fact, even between Hyderabad and Pochampally, relevant prices are sometimes found to vary by as much as 15–20 per cent.

There is a manufacturers association in Pochampally. About 103 members are on the rolls. As an illustration, a 'well performing' master weaver purchases (mulberry) silk from Bangalore traders and reeling units and gets sarees manufactured by household units on a job-work basis. His turnover is about Rs 8 million. His annual cost of production include: raw material yarn of Rs 6 million that he invariably purchases on a one-month credit basis. The cost of credit is about 2 per cent per month, effectively, charged in terms of a markup on price by suppliers. The total yarn cost is therefore Rs 6.18 million per annum; in the case of chemicals and dyes the cost is, in effect, about Rs 500,000. Job-working (labour) charges are Rs 1 million, and about Rs 320,000 is, therefore, believed to be the 6 per

cent profit margin on sales. However, the opportunity cost of own funds used for 'rotation' in business of about a total Rs 2.2–2.5 million is not considered! Most sales are invariably on the basis of a cash discount of up to 10 per cent as, alternatively, realisation of cash from retailers in Mumbai, Kolkata, and Delhi, take two to four months to materialise. He requires funds for the large work-in-process time of 45 days in terms of payment for inputs and job-working charges. He also, ideally, requires funds for credit sales. Unfortunately, like most other master weavers in the region he has no facility with a bank.

The cash rolling period (yarn stocking + work-in-process + credit realisation) of this enterprise is, therefore, over three months, if the cash discount option is forsaken. Like other master weavers, he has no working capital facility but only a current account in a bank to receive and disburse funds. Master weavers like him could think of sourcing certain chemicals and dyes in the form of a hard network for bulk purchase. Out of his (quarterly) cyclical requirement of funds, over Rs 100,000 are for chemicals and dyes that he could largely plan for, in advance. A network of about 10 similar and like-minded master weavers could come together to ideally source chemicals in quantities (Rs 1 million per quarter) offered by enterprises in manufacturing bases like Ahmedabad. A 20 per cent reduction in cost of such material would imply a Rs 100,000 annual benefit per similar enterprise in the network. The burden on household units is also reduced! ROI for such a project implying four rotations a year is about 80 per cent and net profit of the master weaver can be increased by about 30 per cent viz., from Rs 320,000 to Rs 420,000 per annum. Similarly, 'networked' sourcing of yarn in bulk could also facilitate a 3 per cent reduction in cost or increase in profits by about 28 per cent. In fact, such modes, as also increased participation in domestic fairs, for direct sales to consumers through fairs organised by agencies such as the FICCI or the ITPO are the only means

to make any profit margins on sales if we consider the opportunity cost of own labour and own capital invested of Rs 2–2.5 million by a master weaver! Common purchase and marketing for specific purposes is an imperative. Informational gaps also exist on the marketing front. A web page could help master weavers reach 'low-volume-customised-order' requiring domestic consumers directly to increase both turnover and margins.

With regard to enterprises operating as co-operative societies, tying up with agencies such as the South India Producers Association (SIPA) and other fair trade organisations could help increase access to domestic and international markets. The one relatively large society in the cluster has a turnover of about Rs 15 million and participates in some national fairs, largely, that of the DC (H). The performance of the society has, however, been rather poor with declining sales performance. The investment of a household enterprise in looms is about Rs 5,000 per loom (market rates) for about four looms. The household enterprises (operating under the fold of a society or otherwise) also invest in necessary expenses over the 45-day period in terms of manufacturing cycle viz., labour, dyes and chemicals of about Rs 4,000. An additional option for enterprises of this typology is to approach markets directly and source cheaper institutional finance for some input purchase in cash. An MCGF like scheme will help them do this. A water softening plant may also be installed for a group of enterprises to use under the aegis of developmental schemes of the DCSSI. Other CFCs may be also considered for implementation under various private-public partnership programmes of the Government of India departments. In summary, a counsellor will have to evolve and help implement different options based on the profile of target enterprises in a sector.

Considering the management aspects of a master weaver in the sector, it is evident that entrepreneurs expect

a standard profit margin regardless of the product mix and contribution. A contribution analysis of a master weaver in the sector is as follows:

<i>Saree Type (Product Mix)</i>	<i>Sales Price Per Saree</i>	<i>Variable Cost</i>		<i>Contribution</i>
		<i>Raw Material</i>	<i>Labour</i>	
1.	Rs 1,100	800	200	100
2.	Rs 2,000	1,200	400	400

To make more costly sarees, the number of days required increases. It is, about four to five days for Type 1 and six to seven days for Type 2. The margin on Type 2 saree is higher than Type 1 saree in both percentage and absolute terms. Hence, broadly, a special discount on Type 2 may be offered rather than a standard discount on all varieties. This could help enhance offtake of Type 2 varieties, which is a costing and pricing mode to enhance performance.

To broadly summarise, targeting a low-volume customised market is a niche they could develop. Increased margins may be, therefore, secured. However, greater and direct access to customers is necessary for this. A web page and e-mail address could serve as a necessary starting point. The cost of purchase and capital reduction is, however, a simultaneous activity for necessary pursuit by master weavers in this cluster who together currently have an aggregate turnover of about Rs 300–400 million. Labelling of products by the master weavers akin to the initiative at the HBPT cluster near Jaipur could also help thwart the unfair ‘Pochampally cut’ or ‘design’ competition. As a matter of fact, the enterprises in Pochampally have much to learn from the successful initiatives of hand-block printing enterprises near Jaipur. Their problem with regard to screen printers in nearby regions who sometimes palm off cheaper screen-printed products as hand-block printed

ones was resolved through 'labelling' their products. Dozens of groups of small artisans have benefited from institutional finance on an MCGF mode. Design development has been facilitated by tying up with national institutions. Direct international marketing as also organising own fairs or exhibitions in key Indian cities has also been facilitated by small industry experts from the UNIDO, Cluster Development Programme in India. Design development on CAD packages has been also facilitated by the NID.

Similarly, consider the case of the coir enterprises at Alleppey. Three broad typologies of enterprises are evident along the supply chain. There are small exporters, small matting manufacturers and tiny mat manufacturers. In the case of tiny mats manufacturers, a consortium of 15 manufacturers has been formed by the Coir Board and the EDI to avail of the MCGF scheme. The objective has been to seek funds in order to avoid costly informal finance and facilitate common raw material purchase. Consortium members may contribute Rs 50,000 with SIDBI contributing a matching grant of Rs 50,000. This fund is deposited with the State Bank of India (SBI). Based on this, a collateral-free facility of Rs 200,000 is offered. This initiative is believed to boost profits by Rs 50,000 per enterprise per annum. Similarly, procuring a second-hand transport vehicle to facilitate collection and delivery of material is expected to cost about Rs 180,000 to the group of tiny manufacturers while the individual benefit may be a 50 per cent reduction in transport costs per enterprise. A common facility centre shearing unit at a cost implication of about Rs 150,000 will facilitate a 5 per cent cost reduction on shearing operations per enterprise. These projects are being supported by the SBI (project uptech) working for the technology upgradation and cluster development of enterprises in the sector in Alleppey. The development of a versatile yarn-manufacturing loom for backward integration and improvement of the existing looms could be facilitated with support of agencies such as South India

Textile Research Association (SITRA), DST and the PSG College of Engineering. This initiative will be of benefit to both tiny mat manufacturers and small matting manufacturers. The establishment of a raw material purchase consortium for yarn of small manufacturers with an average turnover of about Rs 4 million would require a facility of Rs 5 million from a bank for yarn procurement in bulk and will ensure a cost reduction of between 3–5 per cent per enterprise. Establishing a CFC glueing unit would cost about Rs 1 lakh for a group of about 10 small manufacturers and could facilitate a cost reduction of about Rs 10,000 per enterprise per annum. The purchase of a raw material like latex on cash than credit (as is pursued currently) will facilitate a further reduction of Rs 8,000 per enterprise. A CFC glueing unit need to utilise a term loan and working capital of about Rs 60,000. A cost reduction of over Rs 5,000 per enterprise will be facilitated. Further, a common facility dyeing facility would imply an investment of Rs 500,000 on equipment but would result in a per enterprise reduction in cost of up to Rs 20,000. Effectively, all these projects could imply a pay-back period of about two years. With regard to the small exporters who have till date largely relied on the 'Net' or subcontracted orders from the three or four large exporters in the region, group options in terms of commonly participating in fairs abroad and sharing relevant cost of participation, travel and sample development exists. Availing the services of import promotion (developmental) agencies and their international marketing related subsidised services is also an option. Facilitating interaction with the Regional Research Laboratories in Thiruvananthapuram, and other regions could help identify value-added products such as 'horticulture blocks' or 'manure from coir pith', for instance. Both exporters and small manufacturers could benefit in terms of diversifying into value-added products.

Chapter 10

Policy for the Small Enterprise as a Facilitator to Counselling Initiatives

A counsellor with insights into internal and external factors affecting enterprise performance assumes a significant role in helping evolve policy support for enterprises. He has to work closely with policy makers and vice versa. An industry association may also serve as the appropriate fora for representatives. Consider, for instance, the Technology Upgradation Fund (TUF) scheme of the Government of India. The government has allotted about Rs 300 billion for the upgradation and modernisation of the Textile industry. But there have been few takers. The cases of Menal Powerlooms and Chirag Enterprises presented in this chapter highlight the factors hindering the effective implementation of the scheme. The illustration also suggests the means to modify and promote it, thereby making it a win-win proposition for enterprises and bankers alike. The chapter also presents a summary on the role of counsellors and the policy makers.

Case I: Menal Powerlooms, Ahmedabad

Performance Analysis: Anomalies in Costing-Pricing of Products on Rule-of-Thumb, Cost-plus Basis

Menal Powerlooms, which was established in 1990 in Ahmedabad, has a turnover of approximately Rs 14 million a year. The promoter says it operates at close to 100 per cent capacity. The unit operates on a three-shift basis for about 300 days a year. The unit is closed on one day every week because of the power shutdown implemented by the Ahmedabad Electricity Company (AEC). A study of the enterprise reveals anomalies in costing and pricing, dressed-down financial statements and 'fragmentation' of the enterprise making it difficult for a banker to support their request for support of upgradation.

The promoter of Menal Powerlooms adopts a rule-of-thumb method while costing and pricing his output. Consider the costing and pricing mode adopted by the promoter to make fabric for a chiffon saree, which requires a yarn of count 62. The average grey yarn costs Rs 120 per kg while average starch costs Rs 10 per kg in processing. The cost to make 100 m is estimated by means of calculating relevant costs for 3.5 m viz., Rs 130 per kg, that is Rs 455 for every 100 m or 3.5 kg. This is effectively the yarn cost involved for the warp process. The weft process uses 'Reliance' yarn (50/2000) costing Rs 150 per kg. Thus, the cost for 100 m amounts to Rs 450. Therefore, the total cost over warping and wefting works out to Rs 905 per 100 m or Rs 9 per m. Labour costs, electricity and 'cash discount' of Re 1 each is accorded on a per metre basis. Salary amounts to Re 0.50 and the promoter estimates administrative overheads at Re 0.25 per m. Total cost per metre works out to Rs 11.75. The thumb-rule estimate of the promoter is given in Table 10.1.

Table 10.1: Costing and Pricing—Summary of the Method Adopted by the Promoter

	<i>Cost Head</i>	<i>Per Kg</i>
(a)	<i>Warp</i>	
	Raw material costs (grey)	Rs 120
	Sizing	Rs 10
	Total for 100 metres (3.5 kg)	Rs 455
	<i>Weft</i>	
	Reliance (50/2000)	Rs 150
	Total for 100 metres (3 kg)	Rs 450
	(1) Total for warp and weft for 100 metres	Rs 905
(b)	Total (1) above	Rs 9 per metre (approximately)
	Labour	Re 1 "
	Electricity	Re 1 "
	Salary	Re 0.50 "
	Adm. overheads	Re 0.25 "
	Total	Rs 11.75 "

The total cost of production is estimated at Rs 11.75 per m. The promoter prices his product, the fabric, at an average of Rs 12.50 per m, the rate at which he sells to agents and traders. Profit margin is, therefore, believed to be Re 0.75. The profit margin on sales is believed, therefore, to be close to 5 per cent. However, upon analysis of enterprise cost structure in detail, looking into relevant components, different cost estimates emerge. It is obvious that this enterprise which has been largely making chiffon saris has been faring very badly. Technology upgradation is the only method to increase margins.

Performance and Potential Analysis: An Elaboration

The cost structure of the enterprise is estimated in Table 10.2 given its annual cost of production (2001–02).

Table 10.2: Cost Structure

<i>Expenses or Costs</i>	<i>Amount (Rs in million)</i>
Raw material	10.0
Labour (wages)	1.0
Labour (salary)	0.5
Electricity	1.0
Interest on working capital	0.5
Rent	0.5
Total	13.5

The sales data for different products utilising different yarn varieties for the year 2001–02 is given in Table 10.3.

Table 10.3: Sales Data for Different Products

<i>Sr. No.</i>	<i>Yarn Variety</i>	<i>Total Sales (Rs in million)</i>	<i>Selling Price per Metre of Fabric</i>	<i>Total Sales Realisation (in Metre)</i>
1.	62 count (high turn)	2	Rs 18	111,111
2.	62 count (medium turn)	8	Rs 15	533,333
3.	Normal (twist)	4	Rs 13	307,692
	Total	14		952,136

Total sales realisation of fabric is about Rs 14 million and the product mix as per (1), (2) and (3) above has been in the ratio 20 : 80 : 40. It is believed that this ratio holds true for any average year of the enterprise. Therefore, the weighted average selling price (SP) is equal to Rs 14.85 per m. The break-even sales and quantity at 100 per cent capacity utilisation is roughly estimated in Table 10.4.

Table 10.4: Break-even Sales at 100 Per cent Capacity Utilisation (Working Capital is a WCT)

<i>Expenses</i>	<i>Variable Cost (Rs in million)</i>	<i>Fixed Cost (Rs in million)</i>
Raw material	10	–
Labour (wages)	1	–
Labour (salary)	–	0.5
Electricity	1	–
Interest on working capital	–	0.5
Rent	–	0.5
Total	12	1.5

BEP sales is estimated at 75 per cent capacity (total sales of Rs 14 million) or Rs 10.5 million. The total cost per metre is Rs 14.17 and the variable cost per metre is about Rs 12.60. Hence, an anomaly in the thumb-rule costing mode adopted by the entrepreneur vis-à-vis actual costs obviously exists. No wonder the promoter is invariably strapped for cash and frequently resorts to costly 'informal' borrowings. Even excluding depreciation and opportunity cost of 'own' funds locked in business, the total annual cost of production in the enterprise exceeds the selling price!

Fragmentation of the Enterprise and the TUF Scheme— What Should the Promoter Do and Why?

The enterprise is effectively fragmented into five sole proprietary enterprises under the names of different promoters. This is basically to avoid coming under the Factories Act which specifies necessary Act related labour support norms. This, in effect, also helps 'reduce' the amount of excise duty. The avoidance of labour and duty obligations is also believed to help reduce costs. However, 'fragmentation' of annual (statutory) financial statements of the enterprise in terms of low declared per unit net worth and sales performance, affects the scope for technology upgradation. The ideal financial requirement for upgrading technology in the enterprise is believed to be Rs 8 million. Technology upgradation of the enterprise will involve import of second-hand spindle-less powerlooms. No regular term-leading financial institution will support this initiative. This is the major problem with fragmentation—a fate suffered even by relatively well performing units. The technology upgradation fund of the government declared for the sector is hardly utilised. This scenario is common to most enterprises in the sector. To effectively avail of the TUF scheme, the promoter needs to integrate all his enterprises under one banner. At least 'projected' financial statements need to be integrated into one whole and be presentable in terms of standard net worth, liquidity, profitability and turnover ratios and sales performance related norms adopted by bankers during project appraisal. Labour may be employed on a piece-rate basis through contractors to avoid coming within the ambit of the Factories Act. Further technological upgradation will help increase margins and enable the enterprise to make a profit margin on sales. It is estimated that the increased productivity and sales realisation that may be expected under the upgradation plan will help the enterprise realise a margin

of 10 per cent, even after accounting for depreciation charges and debt repayment obligations under the plan. In this case, the corrective measures have to be pursued by the entrepreneur. A counsellor could facilitate necessary transformation of the enterprise. In this particular case, it is also observed that the promoter has invested most of his surplus funds to finance working capital necessary for his enterprise. Hence, offering the required margin towards a term loan for upgradation would imply that he diverts working capital to this end—hardly a feasible option. In fact, analysing a sample of similar enterprises reveals a similar scenario. This essentially gives an indication of the need to modify the TUF scheme so as to incorporate a working capital term loan (WCTL) package along with term loan support. This will ensure more takers for the scheme from this margin-starved industry.

Case II: Chirag Ginners—Forward Integration as a Means to Reduce Risk

Chirag Ashtawadi has a ginning unit Chirag Ginners manufacturing cotton fibre from cottonseeds. The production cost structure of the unit as on March 31 is given in Table 10.5.

Leverage and Business Risk

The total sales turnover of the unit is Rs 170 million a year on an average. About Rs 2.5 million is profit. Break-even sales of the unit is 58.3 per cent (relatively high). Operating leverage equals one. The unit is, therefore, relatively poorly leveraged. What are the options to reduce risk and costs? Raw material prices fluctuate very rapidly and the yearly variations could be as high as 25

Table 10.5: Current Cost Structure of Chirag Ginners, Ahmedabad
(Rs in million)

<i>Cost</i>	<i>Variable Cost</i>	<i>Fixed Cost</i>
Raw material	150	
Labour	3.5	
Power	7.5	
Overheads (salary and maintenance)	–	3.5
Interest cost	3.5	
Total	164.5	3.5

per cent. Hence, suppliers who are small agents sourcing seeds from farmers and offering the same to ginners will not accept an average price paid in advance or by means of post-dated cheques or bank guarantees seeking bulk/cash discounts. In fact, both suppliers as well as ginners are largely speculators on raw material prices.

In the ginning sector, purchase is on cash and sale is on the basis of maximum credit of about one month. The working capital cycle is effectively of about 30 days. For a unit with about Rs 17 crore as annual production cost, about Rs 30 million of working capital is required. Two months is, therefore, estimated as the working capital cycle period. The unit has a credit limit of close to Rs 22 million; the balance is the promoter's margin/contribution to working capital. In sum, the enterprise has invested in very high levels of current assets vis-à-vis margins. The business is largely speculative and has high risk.

Raw Material and the Supply Chain

The enterprise comes under the Factories Act with about 12 full-time (administrative) employees. Labour is

on daily wages or on contract. No export duty is payable. Sales tax is paid by the buyer. By changing the cost structure of the enterprise by virtue of integration (effectively availing of the TUFs), the enterprises' BEP, viz., risk, is reduced. The changed cost structure upon forward integration to spinning is given in Table 10.6.

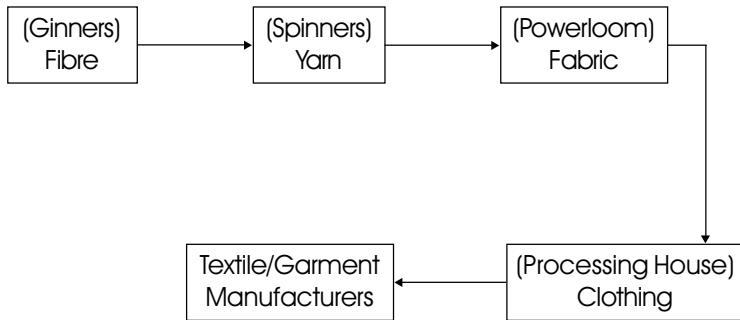
Table 10.6: Likely Cost Structure of Chirag Ginners upon Forward Integration (Rs in million)

<i>Major Expenses</i>	<i>Variable Cost</i>	<i>Fixed Cost</i>
Raw material	150	
Labour	7.0	
Power	20	
Overheads (salary and maintenance)	–	4.6
Interest cost	5.0	10
Total	182	14.6

Even excluding depreciation and other charges, the FC is likely to increase to Rs 14.6 million including interest and repayment of principal on term loan. Enhanced interest (WC), overheads, power and labour will also increase. The revised BEP at a projected sales turnover of Rs 240 million is 25.17 per cent. The new operating leverage could equal 1.34. Garment manufacturing units have been advocating a reduction in customs duty on raw material imports while farmers and ginners want it to be raised. The current rate is about 10 per cent. However, global price fluctuations and monsoons affect relative prices and competition. The supply chain in the sector is given in Figure 10.1.

Value added at the ginning stage is far lower than at the spinning or fabric-making stage. The highest value is added in the garment manufacturing stage. A spinning

Figure 10.1: The Supply Chain



unit that makes yarn also has good export potential. In fact, if this ginning unit integrate forward into a spinning facility, about 4 per cent on sales tax is saved. A TUF scheme support of Rs 50 million, as in this case, is a means of reducing risk for successful ginning sector operators. The promoter will have the scope either to use domestic inputs or imported raw material if the project of making yarn is particularly export oriented. Imported raw material are at times 20 per cent cheaper. Even with a customs duty of 10 per cent, the benefit is high.

The major policy imperatives are, therefore, two-fold. The TUF scheme which could support upgradation in this case of forward integration could also support working capital requirements to a certain extent. It would also disseminate the benefits of upgradation, as for instance, forward integration from ginning to spinning. Business risk is reduced and margins increased. Promoters will have the option of either importing cotton bales from outside or using local cotton depending on price conditions making them internationally competitive. A counsellor needs to work on analysis of enterprises along this mode and perform a cost-benefit analysis to facilitate decision-making at the enterprise level and favourably orient policy at the sectoral level.

Role of Counsellors and Policy Makers—A Summary

Like most manufacturing units in India, enterprises in the leather sector, for instance, are essentially small in size. Labour and raw material costs are the most critical production costs and large economies of scale do not exist on the manufacturing front. Small enterprises may be, therefore, ideally placed on the manufacturing front. However, potential competition from other (Thailand, Indonesia and China) economies of the Far East and South East Asia bodes ill for the sector. The options for revitalisation in order to match competition lies at the enterprise level in terms of professionalism in functional areas of management of finance, marketing and production. It is equally important to frame, policy that encourages marketing, on the domestic and international front via consortia (who have the wherewithal to withstand adversities in markets with high price elasticities and the ability to encourage development of sustainable real and notional differentiation). While

Competition warrants professionalism in management and, the adoption of such measures to build upon marketing strength, reduce enterprise level costs and identify new value added products. This is true of many sectors be they machine tools or natural-fibre based, for instance. While need for networks or consortium oriented policy support initiatives on certain fronts may be obvious, the critical role of counsellors in crystallising common business plans or hard networks is established. The need for effectively involving other actors (such as private and public service providers) *SIDBI*, commercial banks, and the government more proactively with small enterprise actors in a cluster or a region is also a role that could be well served by counsellors.

economies of large-scale manufacture may not be very significant, scale economies (to reduce unit costs) on the marketing, raw material purchase and common facilities front remain significant.

They need to serve as catalytic agents to facilitate effective networking between small enterprise and public/private service providers to ensure sustainable revitalisation and development of small enterprises.

Learning from Lessons of Other Clusters and Sectors

Currently, about 50 per cent of the fans produced in the country are made in Kolkata. However, the industry, and particularly, small units do not have access to testing facilities and quality control equipment and lost out in the market. The low cost and low quality preferring market segment is shrinking. Similarly, the major strength of the Indian leather product sector in Chennai lay in the availability of raw material, cheap labour (in the international context), access to a rapidly well-developed chemical and engineering industry and developed R&D and support institutions. The market for leather and leather products lies largely in western Europe and America. India has an over 4 per cent share in the world market. Nevertheless, the country had been losing out to South East Asian competition. In many product varieties from Chennai and Kolkata market shares have remained relatively sticky. The machine tool and parts clusters in India are several decades old. The small-scale sector contributed to about 25 per cent of the machine tools produced in the country. The machine tool cluster in Batala provided a comparatively cheap and low quality product to cater to the lower end of the market. However, with limited industry growth

and import liberalisation, entrepreneurs may have to survive servicing imported second hand machines! Upon UNIDO interventions in the machine tool cluster in Bangalore, for instance, efficient vertical networking to develop the supplier base of large players and exporters has yielded good dividends. Vendor rating was accorded thrust. Enterprises in coir sector clusters have to learn from such experience of other clusters. Small Manufacturing Enterprises (SMEs) may prove to be of optimal size when focusing on products that target a niche market in terms of low volume customised product requirement such as special purpose machines or specific types of mats. However, in standard mass-market products, consortia on marketing, raw material purchase, common facility centres and financing is the need of the hour.

Similarly, small enterprises into standardised leather product manufacture viz., leather garments and shoes of many types are outpriced by competitors in the South East. Imported electronics and engineering (including machine tool) products are sold in India at a fraction of the manufacturing costs of our domestic entrepreneurs. Securing a cost advantage is critical as are efficiently exploring scope for offer of ideal discount and credit on (a segmented) marketing front. A major lesson to be learnt is that small may well remain beautiful in manufacturing. Marketing, raw material purchase and common facilities requires the muscle of scale.

Further, as indicated earlier in this section, technology upgradation of enterprises is an absolute requirement in different sectors. For example, in the coir product sector, there is scope for upgradation both at the spinning stage and at the product manufacturing and finishing stages. Policy makers will have to understand the problems faced by other sectoral policy makers in implementing the Technology Upgradation Fund (TUF) related schemes. In the textile sector, for instance, only a small fraction of the fund allotted (about Rs 300 billion) has been disbursed for

upgradation even while the scheme is coming to a close in about a two-year period. A TUF scheme for coir-related enterprises may offer a working capital term loan (WCTL) along with regular term loan for upgradation as a part of the TUF scheme. This WCTL may be about 20 per cent of funds disbursed for technology upgradation. This will ensure that cash-starved coir entrepreneurs will be encouraged to go in for upgradation. The TUF scheme may offer 5 per cent interest subsidy, require 20 per cent margin money and the repayment period may be 10 years with a two-year moratorium period. The WCTL may be offered on similar terms. The critical roles of a counsellor in evolving such schemes remain paramount. Intensive enterprise level analysis need be the basis for formulation and implementation of such schemes.

Consortia Approach: The 'Co-opetitive Option'

In a consortia, co-operation need not be on all fronts. They may compete on the marketing front while coming together for raw material purchase, for instance. The size of a consortium will depend on the common business plan. Forming a raw material purchase consortium for Rs 40 million of cash and bulk purchase per operating cycle could be meaningless if the benefit of cash and bulk purchase is only up to Rs 4 million. Economies of scale beyond this level of purchase may not be significant. To encourage such paradigm shifts, policy reorientation with regard to export marketing of products is warranted. Market development assistance in terms of relaxation on eligibility norms for consortium based enterprises, priority for consortia in securing assistance or in allotment of subsidised stalls in fair participation, enhancement in the number of subsidised trips that a consortium enterprise may make by availing air fare subsidy is warranted.

Further, leveraging 'brand building' funds from the ministry of commerce needs to be an initiative of counsellors.

Similarly, consortia for raw material purchase in bulk to avail of cash and quantity discounts, thereby reducing cost, are an imperative that could merit policy support. Consortia financing particularly by very small manufacturers (perhaps through a Mutual Credit Guarantee Fund Scheme) is critical to secure own working capital and meet operating expenses. This will enhance margins and avoid recourse to expensive 'informal' finance. These consortia and 'hard networking' options that will be beneficial for small enterprises merit policy support. Tiny manufacturers' consortia seeking to commonly benefit from a MCGF may require support from a special corpus fund created by the Government of India. Support from SIDBI/NABARD may be forthcoming only for a limited number of demonstration projects every year. Hence, such a corpus may have to be developed to benefit a greater number of networks. It is not only tiny or smaller manufacturers who are collateral starved for working capital. Counsellors may professionally conceive implementation of such support on behalf of networks. A portal to facilitate raw material and product trading may also be developed for different sectors or clusters and monitored by expert counselling, perhaps through associations and after identifying ideal supply sources from across the country and the globe. A portal could facilitate on-line auctioning and trade. This initiative may also be synergised with a 'subcontraction exchange' supported by the DCSSI.

Policy Support to Encourage Product/Market-led Diversification

Cash is the oxygen for an enterprise and, unless alternative sources for cash circulation is available, small

enterprises targeting saturated markets may face an erosion of working capital. Many enterprises in the textile and the leather product sectors serve as perfect reference cases for the same. The option for market-led diversification through enhanced focus on Scandinavian, CIS, East Europe or South American markets for coir enterprises merits attention. Enterprises with scope for product- or market-led diversification have greater resilience to business risk. Counselling support is required for enterprises to explore relevant options in terms of value-added product manufacture and marketing. Routes to revitalisation may, therefore, be product- or market-led. Examples of this can be found in the diesel engine cluster in Phagwara, for instance. A diesel engine could be used as an electric generator with the addition of an alternator. The diesel engine and the component cluster in Phagwara and Ludhiana could benefit from a product- and market-led diversification catering to the requirements of industrial estates. Lessons from the Rajkot and Agra clusters indicate the viability of such options.

Engine manufacturers may also diversify into automotive components for tractor or truck manufacturing. Capital goods imports are being liberalised progressively with advance licensing and duty exemption schemes. Earlier, the government-sponsored subsidy and loan facility induced demand of the domestically manufactured models and import barriers kept away supply of better international lightweight and efficient equipment. Today, product- or market-led diversification is the mode for sustainable survival. Small enterprises need to understand the importance of value-added product identification and development and the need to explore new geographic or niche markets. A counsellor plays a critical role in this regard. Policy support in terms of grants or seed capital for all relevant R&D effort along with venture capital is an option that may be promoted at the sectoral level through relevant apex support institutions. Further, specialised MDA in terms of specifically funding

buyer-seller meets and catalogue shows for consortia in new geographical markets or targeting new segments should be available.

Policy to Promote Innovation, Real and Notional Differentiation

It is through effective policy implementation that greater dynamism was induced in leather clusters. Export-oriented policy norms such as the ban on export of raw and pickled hides and skins in the 1970s and semi-finished leather in 1990 along with incentives for the export of value-added products were successfully implemented. India turned from a hides and skins exporter to a globally competitive finished products exporter. Two possible interventions in the coir sector, for instance, include the establishment of a subcontraction exchange and that of common branding assuming SME associations as the point of intervention. Policy supported subcontraction exchange for different sectors and clusters will ensure that 'rent seeking' by virtue of information asymmetries along the supply chain will be removed. If most enterprise profiles are hosted on a subcontraction exchange-like system, competition will perforce have to shift towards innovation and real differentiation amongst yarn dealers, other input suppliers, manufacturers, processors and exporters. Similarly, common branding initiatives could also facilitate the same. Policy thrust on effectively implementing such options via associations needs to be emphasised. Brand building to the extent of developing Tirupur into a preferred subcontraction base for cotton hosiery products by global 'retailers' is certainly realisable. The role of a counsellor on this area has been elaborated in detail earlier.

Counselling for Network Development and Professionalism in Management

Professionalism in management is necessary for sustainable revitalisation of small enterprises. The diversion of working capital to finance creation of fixed assets is a common means to avoid cumbersome procedures and unrealistic margin and collateral requirements in seeking expansion funds from term-lending institutions. There is a shortage of professionalism in management in ideal capital and cost structuring of projects. Costing and pricing is often thumb-rule based, be it domestic or export-related systems for efficient business decision-making is non-existent. A management course for small entrepreneurs in the small scale sector through associations and supported by the government in terms of conception and perhaps (part) financial assistance, is also relevant in this context.

The industrial counsellor should serve as a catalytic agent in facilitating the transformation of Indian small industry and sustainably revitalise itself. Small may yet remain beautiful and, alive!

While the policy maker could focus on ways and means to reduce customs duties in import of raw materials and other inputs in sectors where productivity or yields are sustainably low in the raw material stage, the counsellor could simultaneously play another critical role. Seasonal availability of cashew has made cashew processors global sourcers. So also are garlic and other processors in the food processing sector. A counsellor needs to work with enterprises to help target this major area of the 'old economy' enterprise operation—where to buy inputs from, when and in what volumes. EOQ implementation alone will not suffice. For optimal volume-based sourcing, 'hard' networks of SMEs are warranted. In fact, today, even wind energy turbines are being sourced and commonly utilised

by networks of smaller enterprises to reduce power costs. The policy maker's role should be to evolve policy support to facilitate such options. The forte of the counsellor should be to identify the areas for intervention.

A counsellor may help a small enterprise identify its cost structure so that business decisions may be made quickly. A cost-cum-cost sheet-based systems tool may be effectively implemented for efficient decision-making in the areas of purchase, sales or profitability. Most important are 'in-effect' isolating the critical success factors for successfully operating an enterprise. Other than sourcing, there may be a need to enhance working capital limits for stocking seasonally available raw material, for instance, or it may be imperative to operate at high break-even and high operating-leverage levels to benefit from cost optimisation and profitability leverage. Establishing a backward-integrated 'trading' enterprise with institutional support (effectively a raw-material 'bank') may be a means to enhance limits—the Nayak Committee notwithstanding! Identifying the optimal scale of operations in different functional areas—procurement, production and marketing—will help an enterprise professionally explore avenues for cost advantage. Identifying the optimal discount or credit stratagem for channel motivation upon a simple contribution analysis will ensure that an enterprise does not suffer from a syndrome of increasing sales but decreasing sales margins. A policy maker may focus on maintaining a strong exchange rate as to mobilise foreign investment of various sorts. It is the role of a counsellor to study its impact on enterprise performance. A strong currency has been affecting India's price competitiveness in the export of 'basmati' rice, for example, vis-à-vis our competitor Pakistan.

Food processing enterprises in Uttar Pradesh, for instance, have the advantage of a large resource base. However, milling rice without a common facility centre (CFC) to reduce 'brokens', financial instruments to

enhance working capital limits, or information on where and when to source packaging (jute bags) or raw material or on value-added niche product manufacture (rice, poha and bread) could but ensure an unsustainable operation. For instance, the need for contract forming and large 'agency role' in terms of utilising certain volumes in processing by self while supplying the excess of such optimally sourced inputs to other enterprises is evidently a critical success factor in grain milling enterprises. Competition from Thailand could affect performance of a rice milling enterprise but so also can a large local 'exporter' who procures paddy at subsidised rates from the Food Corporation of India (FCI)—given the norms for domestic sale by exporters!

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