CHAPTER TWO
SMALL BUSINESS

How can we say a business is

- Micro
- Small
- Medium
- Large

Definition and importance

- There are two approaches to define small business. They are:

  1. Quantitative (measure of size)

  2. Qualitative (Economic/control)

1. Quantitative approach

- Uses size as factor of measurement
- Even the criteria used to measure the size of businesses vary, size refers to the scale of operations. Examples of criteria used to measure size are:
  - ✓ number of employees
  - ✓ total capital investment
  - ✓ volume of sales turnover
  - ✓ total investment in plant and machinery
  - ✓ asset size
  - ✓ volume of production
  - ✓ volume of deposit

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- According to Small Business Administration(SBA) the following general criteria for defining a small business are suggested:

a) Financing of the business is supplied by one individual or a small group. Only in a rare case would the business have more than 15 or 20 owners.

b) Except for its marketing function, the firm's operations are geographically localized.

c) Compared to the biggest firms in the industry, the business is small.

d) The number of employees in the business is usually fewer than 100.

- The definition micro and small enterprises varies from country to country. All over the world, number of employees or capital investment or both has been as the basis for defining micro and small enterprises. On the basis of environment criteria, the generally acceptable division are:

  Up to 19 workers……Micro or very small enterprises.

  20 – 100 worker……Small enterprises.

  101- 500 workers……Medium enterprises.

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- **Micro and small enterprises** – define in terms of paid up capital and number of workers. In Ethiopia context there are two main definitions;
- Micro Enterprises are those business enterprises with a paid-up capital of not exceeding ETB 20,000, and excluding high tech. consultancy firms and other high tech. establishments.
- Small Enterprises are those business enterprises with a paid-up capital of above ETB 20,000 and not exceeding ETB 500,000, and excluding high tech. consultancy firms and other high tech. establishments.

2. Qualitative approach

. Use **Economic/Control criteria**

- The economic/control definition covers:
  1. Market share
  2. Independence
  3. Personalized management
- All three of these characteristics must be satisfied if the business is to rank as a small business.

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1. **Market Share**

- The characteristics of a small firm's share of the market is that it is not large enough to enable it to influence the price of the national quantities of goods sold to any significant extent.

2. Independence

- Independence means that the owner has control of the business. It therefore rules out those small subsidiaries which, though in many ways fairly autonomous, nevertheless have to refer major decisions (e.g. on capital investment) to a higher level of authority.

3. Personalized Management

- Personalized management is the most characteristic of all. It implies that the owner actively participates in all aspects of the management of the business, and in all major decision making activities. There is little devolution or delegation of authority.

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4. Technology

- Small business is generally labor intensive.

5. Geographical Area of Operation

- The area of operation of a small business firm is often local.

Importance of Going in to Small Business

- The desire for individuals to own and operate their own small business is growing.
- For individuals pursuing a career in business ownership, numerous benefits can be attained personally as well as professionally.
- Owning small business have economic, social and political significances some of them are:

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1.**Independence:**

- Most small business owner enjoy being their own boss; they like the freedom to do things their way. Although often a great deal of responsibility is associated with this independence, their willing to assume it.

2. Financial opportunities:

- Another major reason for going into business for oneself is **financial opportunity**. Many small business owners make more money running their own company than they would be working for someone else.

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3. Community service:

- Sometimes an individual will realize that a particular good or service is not available. If the person has reason to believe the public will pay for such output, **he/she will start a company to provide it**.

4. Job security:

- When one owns a business, job security is ensued. The individual can work as long as he/she wants; no mandatory retirement exists.

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5. Family employment:

- Another advantage is the opportunity to provide family members with a place of employment.
- This has several benefits. First, man owner – managers want to perpetuate their business, and how better to do so than to get children or relatives to take it over?
- Second **higher moral and trust** usually occur more in family run businesses than in others.
- Third, in times of **severe economic downturn**, small business owners can provide employment for family members.

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6. Challenge:

- Research reveals that most successful small business owners like to feel they have a chance to succeed (they want to know success is possible) and a chance to fail (success is not a sure thing).
- But one thing in certain the final out come depends heavily on them.
- They want to win or loss on their own ability. This challenge gives then psychological satisfaction.

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Disadvantages of going in to small business:

- It should be recognized that some drawbacks to owing a small business exist:
- ✓ Sales fluctuations risk of failure
- ✓ Competition laws and regulations
- ✓ Increased responsibility
- ✓ Financial loses
- ✓ Employee relations

Class discussion -2.

- Discuss the Economic, social & political aspects of small business enterprise

2.3. Small Business Failure Factors

- Many small business firms cease operations. This may occur due to different reasons some of them are listed below:

Common Causes of Small Business Failures

- Lack of experience
  - Not having sufficient know-how to run a business in the chosen market or area
- Lack of expertise
  - Not having expertise in the essentials of business operations, including finance, purchasing, selling, and production
- Lack of strategy
  - Not taking the time to craft a vision and mission, nor to formulate and properly implement strategy
- Poor financial control
  - Failing to track the numbers and to control business finances

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- Fast growth
  - Not taking the time to consolidate a position, fine-tune the organization, and systematically meet the challenges of growth
- Insufficient commitment
  - Not devoting enough time to the requirements of running a competitive business
- Ethical failure
  - Falling prey to the temptations of fraud, deception, and embezzlement

❖ other common specific causes of failure for small business are:

➢ Neglect: occurs whenever an owner does not pay sufficient attention to the enterprise.

➢ Disaster: refers some unforeseen happening like accidents

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- Inadequate records:
- Lack of information management system:
- Failure to diversify the market:
- Lack of marketing research:
- Legal problems:
- Nepotism:
- One- person management:
- Lack of technical competence: etc.

2.4 Problems in Ethiopian Small Business

- small scale industries have not been able to contribute substantially as need to the economic development particularly because of financial, production, and marketing problems. These still major handicaps to their development. Lack of adequate finance and credit always been a major problem of Ethiopian small business.

- Small scale units do not have easy to the capital market because they mostly organized proprietary partnership bases and are of very small size. They do not have access to industrial sources of finance partly because of their size and partly because of the fact their surpluses which can be utilized to repay loans are negligible.

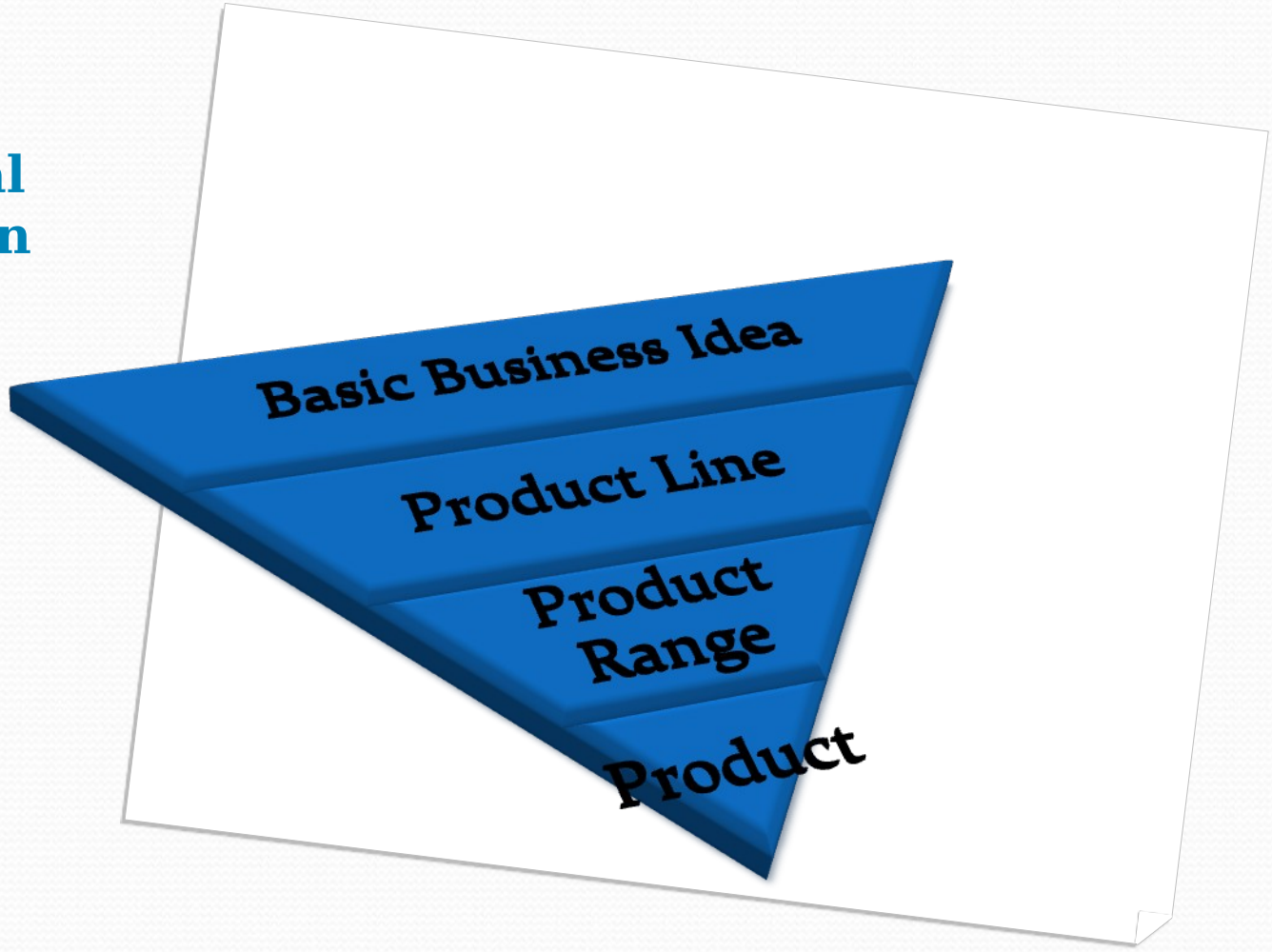
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- Small scale enterprises find it difficult to get raw materials of good quality and at cheaper rates in the field of production.
- Very often they do not get raw materials in time. As a result, these enterprises very often fail to produce goods in requisite quantities and of good quality of a low cost.
- It is only by overcoming all these constraints that small entrepreneurs can hop to make their enterprises successfully.

2.5. Setting Small Business

- The first and foremost step in starting a small business is to find out **a suitable business idea** and give a practical shape to the idea.
- The entrepreneur should be convinced that idea is in fact a **sound** one and likely to give reasonable return on his investment. The search for an appropriate business idea is a complicated exercise because the entrepreneur comes across innumerable business opportunities.
- To choose a business idea, **skill, foresight and ingenuity are required** on the part of the entrepreneur. He should keep in view his **competencies, capabilities and resources** while identifying the business idea.

Figure 2.1 Hierarchical presentation of business idea



2.5.1 What is Basic Business Idea ?

- In practical situation it is seen that an entrepreneur finds it rather convenient to think of product, keeping in view the immediate future rather than the long term goals.
- Businessmen should think of long term goal and the profit when they start a business. The basic business idea, which is at the top of the hierarchy, is to meet the broadest needs of the customers, and has a long life perhaps from 5-50 years.
- Thus, entrepreneurs may think of being in the entertainment film, in automobiles, in medicines, in service industries, etc. The basic business idea facilities **choice of product** under an over all plan.

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- The product line is relatively narrow and has a shorter life. The product line consists of different families of products.
- A unit with a basic business idea for example of **packaging** can manufacture any of the following groups of the products:

1. Glass bottles
2. Plastic packages
3. Paper or wooden packages
4. Aluminum packages
5. Metal packages

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- The product range on the other hand includes different sizes of the product with in the product line. In the example give above different sizes and shapes of glass bottles can be manufactured for varied applications.
- The product is one item of the product range having different specifications like size, material used and weight, etc.
- The basic business idea, which facilitates a choice of the product at different stages of the project, allows for diversification and expansion. But the basic business idea is not always the same. In a dynamic business scheme, one has to carefully watch is one of the basic business idea generating as regards:

    1. Its ability to generate quick returns
    2. Its ability to permit quick changes in the products

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- To be successful in the business, consistently watch the opportunities- **to spot where the entrepreneur has to be sensitive to the market changes, watch demand and supply, study consumer behavior, and grasp the basic business idea**.

- In order to establish a business venture with an entrepreneurial system an entrepreneur needs to take the following steps:

1. Search for business idea
2. Process the ideas
3. Select the best idea

1. Search for Business Idea:

A business idea may be emanated through the following sources

- **Observing Markets:** careful observation of markets can reveal a business idea as:
  - the demand and supply positions
  - Elasticity of demand
  - repetition of purchasing the product
  - composition and pattern of potential customers
  - Survey of the channel of distribution

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- **Prospective consumers:** consumers knows best what they wants and the habits/tastes, which are going to be popular in the near future.
- Contacts with prospective consumers can also reveal the features that should be build into a product or service. **The customer** is the foundation of a business and keeps it going. Therefore, data on consumer needs and preference must be collected.

- **Developments in Other Nations:** people in underdeveloped countries generally follow the **fashion trends** of developed countries. Therefore, an entrepreneur can discover good business idea by keeping i**n touch with developments in advanced nations**.

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- **Study of project profile-** various government and private agencies publish periodic profiles of various projects and industries.
- This profiles describe in detail the technical, financial and market requirements and prevailing position. A careful scrutiny of such project profile is very helpful in choosing in the line of business.

- **Government organizations:** several government organizations nowadays assist entrepreneurs in discovering and evaluating business ideas.
- **Trade fair and exhibitions**: National and international trade affairs are very good sources of business ideas. Trade fairs and exhibitions provide for;

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I. Assessing the market trends in terms of demand potential and type of product required.
II. Meeting a large number of buyers from different states/countries.
III. Assessing the attitude of the competitors in a particular product or marketing area.
IV. Comparing the price and quality of similar products.
V. Establishing personal contacts with dealers/importers/customers.
VI. Projecting new ideas on commercial publicity for promoting sales in the country and abroad.

2. Idea Processing:

I. *Preliminary evaluation and testing of ideas*- once business ideas are discovered, screening and testing of ideas is done. The following considerations are significant in the evaluation and testing of business ideas.

a) **Technical feasibility-** refers to the possibility of producing the product. technical feasibility of an idea is judged in terms of availability of necessary technology, machinery and equipment, labor skills and raw materials. The advice and assistance of technical experts may be necessary to judge the technical feasibility of various business ideas.

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b) Commercial viability- a cost benefit analysis is required to ascertain the profitability of the ideas. There is a difference between a business idea and a business opportunity. While the idea for a product or service may be workable (technically feasible), the proposed business built on this may not profitable.

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II. *Detailed analysis-* after preliminary evaluation of the idea, the promising idea is subjected to a thorough analysis from all angles. Full investigation is carried out in the technical feasibility and economical viability of the proposed project. financial and managerial feasibility of the idea is tasted. At this stage a lot of information is required.

III. Consultations with experts in various areas of the industry may be necessary to carry out the detailed analysis. Due care should be exercised at this stage because the idea is finally accepted or rejected at this stage.

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- After evaluation of a business idea is completed, the findings are presented in the form of a report known as '**feasibility report or project report**'.
- This report helps in the final selection of project. It is also useful for procuring licenses, finance, etc from governmental agencies.

3. Select the best idea

- The feasibility report is analyzed to finally choose the most promising idea. Generally, the following considerations influence the selection of idea for a product or service.

A) Products whose imports are restricted or banned by the government.

B) Products, which can be exported easily and profitably.

C) Products whose demand exceeds their supply so that there exists ready demand.

D) Products in which the entrepreneur has manufacturing and or marketing experience.

E) Parent ancillary relationships, i.e., the product are to be manufactured for a parent company.

F) Products, which showed high profitability.

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G) Products based on the expansion or diversification plans of existing firms of the family/friends/relatives.

H) Products, which ensured specific advantages. The advantages might accrue because of the scale of the industry or the location of the factory or technology of manufacture.

I) Products favored by the country's industrial/licensing policy.

J) Products for which incentives and subsidies are available.

2.5.2. Project Identification and Classification (What project an entrepreneur should have?)

- Webster New 20th century Dictionary define project as a scheme, design, a proposal of something intended or devised. The dictionary of management regards it as an investment project carried out according to a plan in order to achieve a definite objective with in a certain time and which will cease when the objective is achieved.

- **Project-** can be defined as a scientifically evolved work plan devised to achieve specific objective within a specified period of time.

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- Taken in this perspective, while projects can differ in size, nature, objectives and complexity, they must all partake of three basic attributes of being a course of action, of having specific objectives and of involving a definite time perspective.
- The objective may be to create, expand and/or develop certain facilities in order to increase the production of goods and/or services in the community.

Project classification

- Projects have been classified in various ways by different authorities. Little and Mirrelees divide projects into two broad categories, viz., quantifiable projects and non quantifiable projects.
- Projects can also be classified on the basis of
  - Sector wise
  - techno-economic characteristics.
  - nature of the project and its life cycle.

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Quantifiable and non-quantifiable projects

- Quantifiable projects are those in which a reasonable quantitative assessment of benefits can be made. Example, industrial development, power generation, and mineral development are forming part of quantifiable projects.
- Non-quantifiable projects are those where such an assessment is not possible. Example health, education, and defense.

2. Sectoral Projects:

A project may fall in the following sectors:

a) Agriculture and related sector.

b) Irrigation and power sector.

c) Industry and mining sector.

d) Transport and communication sector.

e) Social services sector.

f) Miscellaneous sector.

The sector classification of projects is quite useful for resources allocation at macro levels.

3. Techno-Economic Projects:

Techno-economic projects classification includes factors intensity-oriented classification, causation-oriented classification, and magnitude-oriented classification.

A) Factor intensity oriented classification; the factor intensity is used as a base for classification of projects such as capital intensive or labor intensive which depends upon the large scale investments in plant and machinery or human resources.

B) Causation oriented classification; the causation-oriented project are determined based on its causes namely demand based or raw material based projects. The non-availability of certain goods or services and consequent demand for such goods or services or the availability of certain raw materials, skills or other inputs is the dominant reason for starting the project.

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c) Magnitude oriented classification; the size of investments from the basis for magnitude-oriented projects. Projects may thus be classified based on its investment such as large-scale, medium-scale, and small-scale projects.

4. Financial institutions classification:

- Some financial institutions in some countries classify projects according to their age and experience and the purpose for which the project is being take up. They are as follows;

  a) New projects

  b) Expansion projects

  c) Modernization projects

  d) Diversification projects

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- The projects listed above are generally profit-oriented and the service-oriented projects are classified as under;
  - a) Welfare projects
  - b) Service projects
  - c) Research and development projects
  - d) Education projects

Project Identification

- Project identification is concerned with the collection, compilation, and analysis of economic data for the eventual purpose of locating possible opportunities for investment and development of the characteristics of such opportunities.

- Opportunity refers to any factor that offers promise or potential for moving closer or more quickly towards the firm's goal. For example, new market, a growing demand for the products or services that a small business provides. According to Peter Drucker (1955), opportunities are of three types;

1) Additive opportunities- are those opportunities which enable the decision maker to better utilize the existing resources with out, in any, involving a change in the character of the business and involves minimum disturbance and hence a least risk.

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2) Complementary opportunities- involve the introduction of new idea that lead to a certain amount of change in the existing firm's structure.

3) Breakthrough opportunities- involve fundamental change in both structure and character of a business.

- Additive opportunities involve the least amount of disturbance to the existing state of affairs and hence the least amount of risk. The element of risk is more in the other two opportunities. When the element of risk increases, it becomes more important to precisely define the scope and nature of the project idea, to develop alternative solution for achieving the project objectives and to select the best possible approach so as to minimize both resources consumption and risks and to optimize the return or gains.

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- Projects identification cannot be complete without identifying the characteristics of a project. Every project has three basic dimensions- inputs, out puts, and social costs and benefits. The input characteristics define with the project will consume in terms of raw materials, energy, manpower, finance and organizational setup. The nature and magnitude of each of these inputs must be determined in order to make the input characteristics explicit.

- The output characteristics of a project define what the project will generate in the form of goods and services, employment, revenue, etc. the quantity and quality of all these outputs should be clearly specified.

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- In addition to inputs and outputs every project has an impact on the society. It certainly affect the current equilibrium of the demand and supply in the economy. It is necessary to evaluate carefully the sacrifice, which the society will be required to make, and the benefit that will accrue to the society from a given project.
- The project should have to consider the SWOT and should be designed accordingly. SWOT is a series of steps one has to consider in evaluating a business opportunity and arriving at a decision on starting a business or not. The SWOT approach compels individuals to think or reason out systematically and analytically the important factors strengths, weakness opportunities, and threats, which can be termed as the internal (strength and weakness) and external factors (opportunities and threats).

Project Objectives

- Project objective is an important element in the project planning cycle. Project objectives are concerned with defining in a precise manner what the project is expected to achieve and to provide a measure of performance for the project as a whole. Objectives are the foundations on which the entire construction of the project design is built. The essential requirements for project objectives are;

  a) Specific, not general

  b) Not overly complex

  c) Measurable, tangible and verifiable

  d) Realistic and attainable

  e) Established within resources bounds

  f) Consistent with resources available or anticipated

  g) Consistent with organizational plans, policies and procedures.

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- The project objectives are aimed to complete the project on time, completion of the project within contemplated costs and the completion of the project at a profit to the company.

- Project objectives are divided into two categories, namely, ‘retentive’ objectives and ‘acquisitive’ objectives. Retentive objectives are concerned with the retention and preservation of resources like money, time, energy, equipment and skills. Acquisitive objectives involve acquisition of resources or attaining states that the organization or its managers do not have.

- Project objectives are also economical and social in nature. The economical objectives of the project are in the form of profit oriented. The social project objectives are service-oriented.

- ***Desk research and Techno-Economic Survey-*** are two important techniques of project identification. Desk research implies the collection and use of information from published sources like journals, magazines reports, etc. techno-economic survey is an investigation conducted by a team of experts for identifying the industrial development potential of an era.

- Data and product identification may be obtained from the following sources;

  a) Industrial potential surveys

  b) Lead bank survey reports

  c) New process/product development in research laboratories

  d) Literature on industries within the country and abroad

  e) Import/export statistics

  f) Profitability studies of selected industries

  g) Studies on price and shortage of certain commodities

Project Life Cycle

- Like human beings, projects also have a life cycle. Project life cycle consists of three main stages:

1. **The pre-investment phase:** this is the first phase in the life of a project. It is primarily concerned with:

- objective formulation,
- demand forecasting,
- selection of optimal strategy,
- evaluation of input characteristics,
- projections of the financial profile, and
- if necessary cost benefit analysis and ultimately the pre-investment appraisal. The project idea is developed into an investment proposition during this phase.

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2. **The construction phase:** this phase begins after the investment decision is taken. Resources are invested during this phase in building the basic assets of the projects, which can in due course be utilized to achieve the project objectives.

- The assets may be in the nature of land and buildings, plants and machinery, ancillary accommodation, communication services, control systems and marketing organization.

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3. The normalization phase: this phase starts after the trial turn of the project framework developed during the construction phase. It involves routine procedures, which are performed in a cyclic order. The primary objective of this phase is to produce the goods and services for which the project was established. For this purpose, a provision has to be made for raw materials and other consumables. These can be determined by analyzing the process cycle identifying the sequences of process operations. Projects, which do not involve production of goods, do not require raw material but only supplies or supporting goods needed to sustain the project process. Thus, the assets created during the construction phase are utilized during the normalization.

2.5.3. Definition of Industry and Small Scale Industry

- ***What is industry?*** An industry is an institution where raw material is purchased from suppliers, converted into finished product, using machinery and labor, and sold to buyers. Conversion of raw material means changing the size, shape, chemical properties, and assembling different parts, etc.

- An industry is able to carry out the functions of buying, manufacturing and selling its product with the use of an organization; an organization being a collection of people with of different skills, who coordinate the various functions involved.

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- **Small Scale industries-** have been defined as industrial units engaged in manufacturing/preservation activities or repairing/servicing operations including such operations as quarrying, with original environments in plant and machinery not exceeding Br. 1,000,000.

1. The first key to success in any manufacturing activity is to select the right product.

- In the beginning, information of possible lines of activity must be obtained, by talking to knowledgeable people, from industrial publications, or from various organizations. The information available from these sources may be supplemented by one's ideas and some alternative feasible lines of activity identified. These lines of activity must necessarily be those, which are consistent with one's own personal qualities and capacity. They must essentially be of interest to the entrepreneur. These must be examined with a view to assess:

  a) The marketing aspects

  b) Technical aspects

  c) Financial aspects

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2. Having selected a product, detailed project report needs to be prepared. This will cover the following aspects:

a) A detail estimate of demand is to be made.

b) Technical specifications of the process should be carefully studied.

c) The equipment required and there sources are to be specified.

d) Requirements of space-land, shed etc. and other utilities like power and water are be assessed

e) Manpower requirements of direct and indirect personnel are to be determined and their availability ensured.

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f) The total cost of the project to be worked out and the means for financing it identified; quotation for equipment, material, etc., have to be obtained; information of financing policies of banks and other financial institutions has to be gathered.

g) Like the above information, the economics of the entire scheme at projected operating levels is to be assessed. The break-even point must be well below the envisaged levels of operations for adequate profit.

3. The detail project report having been prepared and availability of the enterprise established, the action phase begin.

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- The form of ownership is to be decided upon and the company formed and registered. Following this, action directed towards obtaining finance, necessary license, and necessary infrastructure is to be taken. This would be involve dealing with various government bodies and other institutions like: financial institutions- for finance; Sales tax, income tax authorities- for respective registration; license authority –for obtaining industrial license and license like for raw material procurement; Municipal Authorities and Electricity Boards- for requisite utilities. Directorate of industries, Municipal authorities, etc, for land, factory, and shed, etc.

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4. Once all the required authorizations and sanctions have been obtained, simultaneous action is to be taken for the following:

a) Ordering machinery from suppliers.

b) Obtaining utilities like power and water connections

after construction of shed, if necessary.

c) Recruitment of staff.

d) Arranging supplies of materials.

e) Arranging for distribution of the product.

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5. Once these are complete, the plant is ready for commissioning. Trail run may be made and at this stage promotional work like efforts may be made to pave the way for introducing the product. When the first few batches of the product are introduced in the market, information regarding its acceptance is to be gathered. On the basis of feedback obtained, the process/product has to be modified until acceptable out-put is obtained.
6. The unit is then ready for commercial production.

END OF CHAPTER TWO

THANK YOU