CHAPTER ONE

ENTREPRENEURSHIP AND FREE ENTERPRISE

Objectives of the chapter

At the end of this chapter, students will be able to;

- ♣ Define the terms entrepreneur, entrepreneurship and intrapreneur.
- ♣ Understand the differences between entrepreneur and owner, entrepreneur and entrepreneur, entrepreneur and inventor.
- ♣ Understand the major traits and functions of an entrepreneur.
- ♣ Identify different kinds of entrepreneurs and the challenges faced by women entrepreneurs.
- ♣ Discuss the main and major processes of entrepreneurship.

Chapter description

This chapter discusses more about who are entrepreneurs and their responsibilities and special characteristics than other business individuals like managers, entrepreneurs, investors, etc. furthermore it describes about the major functions and success criterion for an entrepreneur.

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1.1 Definition and philosophy

The term ‘entrepreneur’ first of all appeared in the French language. The word ‘Entrepreneur’ is derived from the French word ‘Enterprendre’ meaning ‘to undertake’. In fact, in the 16th century, the Frenchmen who undertook military expenditures were referred to as ‘Entrepreneurs.’ It was extended to cover construction and other civil engineering activities in the 17th. Later on, in the 18th century, this term got associated with persons who started their own enterprises. Richard Cantillon, an Irish man living in

France, was the first economist who introduced the term ‘entrepreneur’ referring to the risk taking function of establishing a new venture.

The ‘entrepreneur’ is very much related to the term ‘entrepreneurship.’ Both these terms are often used interchangeably. But, they are conceptually different. Hence, before dealing at length about entrepreneurship, it is better to have an exposure to the term entrepreneur.

Generally speaking, entrepreneur refers to a person who establishes his own business or industrial undertaking with a view to making profit. An entrepreneur is considered to be an originator of a business venture. He takes the role of an organizer in the process of production.

An entrepreneur is one of the important segments of economic growth. Basically an entrepreneur is a person who has the initiative, skill for innovation and who looks for high achievements. He/she is a catalyst agent of change and works for the good of people.

There have been hundreds of definitions in dozens of books. Some of them are given as: Entrepreneurs are action-oriented, highly motivated individuals who take risks to achieve goals. Entrepreneurs are people who have the ability to see and evaluate business opportunities; the ability to gather the necessary resources to take advantage of them, and the ability to initiate appropriate action to ensure success.

Various experts have defined the term entrepreneur in different words. Some of the definitions are as follows:

Karl Vesper has research entrepreneurship and entrepreneurship and explains that its nature is a matter of individual perception: Economists may view entrepreneurs as those who bring resources together in unusual combinations to generate profits: Psychologists tend to view entrepreneurs in behavioral terms as those achievement-oriented individuals driven to seek challenges and new accomplishments; Marxist philosophers may see entrepreneurs as exploitative adventures, representatives of all that is negative in capitalism; Corporate managers too often view entrepreneurs as small business persons lacking the potential needed for corporate management. Vesper suggests that those of us who strongly favor a market-economy view entrepreneurs as pillars of industrial strength-the movers and shakers who constructively disrupt the status quo.

Oxford English Dictionary (1933) defined entrepreneurs as “one who undertakes an enterprise, especially a contractor-acting as intermediary between capital and labor.” Undertaking of an enterprise involves combining capital and labor for the purpose of production. Anyone who undertakes this task is an entrepreneur. The entrepreneurial class is an ‘employing class’ as it creates jobs.

Richard Cantillon was the first to introduce the term ‘entrepreneur’. He defines it as “the agent who buys means of production that he is going to sell at prices that are uncertain at the moment at which he commits himself

to his costs". He illustrated his concept of entrepreneur by taking the case of a farmer.

A famer pays out contractual incomes, which are 'certain' to the landlords and laborers, and sells at prices that are 'uncertain'. Similarly, merchants who commit themselves to certain payments in expectation of uncertain receipts are essentially "risk bearing directors of production and trade."

Thus, an entrepreneur is the individual who bears uncertainty and takes risk. The spirit of enterprise makes one an entrepreneur. But Peter Drucker disagrees with this view. According to him "Entrepreneur is someone who always searches for change, responds to it, and exploits it as an opportunity." Entrepreneurs are successful to the extent they define risks and confine risk. Successful innovators are conservative. They have to be. They are not 'risk focused'; they are 'opportunity focused'. The entrepreneur is a combination of the thinker and the doer. The entrepreneur sees an opportunity for a new product or service, a new approach, a new policy, or a new way of solving a historic problem. But, the entrepreneur also does something about what is seen. The entrepreneur seeks to have an impact on the system with his/her idea, product, or service. It is this thinking-doing combination that gives entrepreneurial efforts their special appeal.

In the words of J.B. D.Say, "the entrepreneur is the economic agent who unites all means of production, the labor of the one, the land of another and the capital of yet another and the capital of yet another and thus produces a product. By selling the product in the market he pays rent of land, wages to labour, interest on capital and what remains is his profit."

Thus, say used the term entrepreneur in the sense of an organizer who combines the various factors of production. He produces a socially valuable product and sells the produce in the market from which he pays to the suppliers of land, labor and capital. What remains is his profit. Say makes a clear distinction between the capitalist a s financier and the entrepreneur as a coordinator and organizer of a business enterprise, which the entrepreneur needs the art of superintendence and administration.

The above combining role is a distinctive one when applied to the organization of a new concern. But when applied to a going concern it denotes little more than routine supervision and control.

According to Noah Webster, entrepreneur is "one who assumes the risk and management to business"

According to Evans "entrepreneurs are persons who initiate, organize, manage, and control the affairs of a business unit that combines the factors

of production to supply goods and services, whether the business pertains to agriculture, industry, trade or profession: ”

According to Joseph Schumpeter, an entrepreneur is an innovator who brings economic development through new combinations of factors of production. In other word, a person who introduces innovative changes is an entrepreneur and he is an integral part of economic growth. However, this interpretation of the entrepreneur has been criticized. Under developed countries like Ethiopia where private capital is shy and small, skill and technical knowledge is highly deficient and socio-economic infrastructure is inadequate do not have many innovators. Such countries need ‘imitators’ who can implement the innovations made in developed countries.
Dewing has rightly put it as follows: “The function of entrepreneur is one that promotes ideas into business.”
The usually accepted meaning of entrepreneur in ‘economics refers to an ideal type rather than the real person. In addition to the coordination of the factors of production, high level of achievement also makes an individual entrepreneur. Therefore, McClelland defined an entrepreneur as “someone who exercises some control over the means of production and produces more than what he can consume in order to sell (or exchange) it for individual (or household) income.”

The meaning of entrepreneur may also depend upon the level of development of a country. For instance, in a developed country only people carrying out innovations are termed entrepreneurs. But in underdeveloped countries, imitators are also considered entrepreneurs.
Thus, the term ‘entrepreneur’ has been defined in various ways-an innovator, a risk taker, a resource assembler, an organization builder, and so on. Truly speaking, an entrepreneur is all combined into one. He introduces new ideas, carries on new activities, coordinates the factors of production and decides how the business shall run. He anticipates the future trend to demand and price. He has vision, originally of thought and ability to take calculated risks.

An entrepreneur perceives an opportunity in a new field or in an existing one. For example, Mr. Akio Morita, the president of Sony Corporation of Japan created the Walkman personal stereo. On the other hand, Henry Ford, the founder of Ford Motor Co-of USA, applied the division of labor to the production automobiles in a new way, the assembly line. Therefore, an entrepreneur perceives a need and then brings together the manpower, materials and capital required to satisfy that need. An entrepreneur either originates a new business venture or carries out productive changes in an existing venture. However, entrepreneur often play other roles, especially those for capitalists and man anger.

Entrepreneurs take the risks necessary in producing goods and services. In this way they act as the energizers of the business system. They are instruments of change.

1.2 The entrepreneur Vs Owner Manager

Entrepreneur –take existing resources and redeploy them, often in a creative way, to give them greater economic value. This original meaning of the word implies that they are agents of change, innovators of new products, methods, or markets. They are less concerned with managing what exists in the most efficient manner, and they are more involved in looking for and exploiting new opportunities. They can work in small and large companies.

Owner–managers-may or may not be entrepreneurs. They own and manage a small enterprise, in a way, which fits with their personal motivations. They may therefore, be opportunist, entrepreneurial type owners, or they may be conservative, artisan type managers more intent on survival than seeking innovative change and growth.

They are many different types of entrepreneurs and owner managers from the ‘soloist’ who prefers to go it alone, to the ‘grouper’ or team builder who thrives on shared decision making; from ‘high-tech’ engineer to the ‘alternate life style’ craftsman: Entrepreneurial activity is not confined to the small business sector, nor it is always found in small firms.

Entrepreneur Vs Manager

Generally, an entrepreneur and a manager are considered to mean the same and are used as interchangeable terms. In many cases the roles of entrepreneur and manager may overlap. In proprietorship and partnership and even in small companies the entrepreneur himself acts as the chief executive. But a rapid manager cannot be described as an entrepreneur. The main points of distinction between entrepreneur and manager are described as follows.

1. **Innovation**- the entrepreneur does not live with the status-quo (current or existing state…. the existing state of affairs (at a particular time)" or "the situation as it currently exists). He works to change in accordance with his or her personal vision and values. He is more than an inventor. An inventor only originates the invention. But the entrepreneur goes much further by exploiting the invention commercially or by applying the invention. On the other hand, the manager keeps running a business on established lines. He is neither

an inventor nor an innovator. An entrepreneur changes the factors combinations and thereby increases productivity and profit. But a manager only deals with day to day affairs of a going concern. An entrepreneur is a change agent while a manager is the product of change. An entrepreneur is not a mere executive though he may also be appointed as one of the promotion of his company. A manager mainly acts as an executor of plans prepared by the entrepreneur.

2. **Risk-Taking -** an entrepreneur takes calculated risks. He is not a gambler but he faces uncertainty and assumes risks. He may jeopardize his own financial security and the security of others. By contrast, the manager is less tolerant or uncertainty. He does not face the uncertainty of a new venture with its potential for failure and financial loss. He does not share in business risks.
3. **Reward -** an entrepreneur is motivated by profits while the manager is motivated by extremely imposed goals and rewards. The gains of an entrepreneur are uncertain and irregular and can at times be negative. The salary of a manager is on the contrary, fixed and regular and can never be negative.
4. **Skills -** the roles of entrepreneur and manager demand different types of personal skills. An entrepreneur needs intuition, creative thinking and innovative ability among other skills. On the other hand, a manager depends more on human relations and conceptual abilities.
5. **Status-role-** an entrepreneur is self-employed, he is his own boss and enjoys an independent status as the owner of the enterprise. By contrast, a manager is a servant, i.e., salaried person serving in the enterprise of someone else i.e., entrepreneur. Thus, he is not independent but the dependent of the entrepreneur.
6. **Response to authority -** one of the main features that distinguish managers from entrepreneurs is their ability to identify in a positive constructive way with authority figures using them as role models. This type of behavior is largely absent in entrepreneurs. Case histories of many entrepreneurs suggest that it was their inability to submit to authority and accept organizational roles that drove them to become entrepreneurs. In a sense they were 'misfits' who had to enact their own environment.
7. **Continuity –** entrepreneurial activities are discontinuous appearing to initiate change in the production process and then disappearing until another change is initiated. Managerial activities are mainly continuous involving an ongoing coordination of business operations.
8. **Venture –** an entrepreneur sets up a new enterprise or undertakes a venture for his personal gratification. A manager does not take a new venture and renders services in an existing enterprise.
9. **Prerequisites –** in consonance with the entrepreneurial role, an entrepreneur needs pre-requisites like mission, creative thinking, risk-bearing ability, etc. but a manager needs distinct qualifications such

as knowledge of human behavior, a management theory, etc. because, managers are made not born.

10. **All functions –** as entrepreneur has to perform many functions on order to run the enterprise successfully. A manager renders only the managerial services in an enterprise.

1.3 Entrepreneur Vs Intrapreneur

In recent time, a new brand of corporate entrepreneurs called "intrapreneurs" has come into picture. Since they emerge within the frontiers of an existing enterprise, they are called intrapreneurs. In refers to 'within'. In big organizations, the top executives with intrapreneurial talents are encouraged to generate new ideas and then convert them into products through research and development carried out within the organization itself. If the talents inside an organization are regarded, the entrepreneur could avoid stagnation and decline in his enterprise.

This concept of intrapreneurship has gained much popularity in developed countries like America. If the managements are not receptive to their new ideas, they tend to leave their parent organization and start ventures of their own. When Steve Wozniak could not get his dream of making a small computer fulfilled at Hewlett Packard, he left that popular company. He then teamed up with Steve jobs to form Apple Computers, which has subsequently become a very prestigious organization. It is found that many of such intraprenuers have become exceedingly successful in their ventures to the extent of even causing a threat to their parent organization. Generally, intrapreneurs breed new and innovative ideas to the entrepreneurs who inaugurate new products.

Companies should provide intrapreneurs with adequate financial resources and freedom so that their ideas can be developed. Hence, selected top executives should be given a status within the organization similar to that of an entrepreneur in the society. What drives talent within an organization is of monetary gain, but, a deep desire of personal achievement. Thus, an

intrepreneur works within an established organization. Most often he belongs to the family member of the founder.

The differences that exist between these two types of business leaders are given below in the following table.

Table 1.1 Differences between entrepreneur and intraprenuer

Entrepreneur	Intrapreneur
Independent: An entrepreneur is an independent person in his business operations.	**Dependent:** On the other hand an intrapreneur is a semi dependent on the promotes/owners of the organization.
Need not be highly educated: it is not necessary that an entrepreneur should have a high education. He can learn everything by experience provided he has the basic qualities of a successful entrepreneur.	**Highly educated**: Intrapreneur enters into existing organization with a high education and qualification. He is indeed a business specialist in the chosen field.
Fund raising: an entrepreneur himself raises funds necessary from various sources and guarantees the return to investors/creditors for starting and establishing.	**No fund raising**: an intrapreneur neither raises the capital nor guarantees any returns to the suppliers of capital. He is completely free from the botheration of raising funds.
Risk bearing: an entrepreneur has to bear all the risks involved in the business by himself.	**No risk bearing:** an intrapreneur need not bear any risk involved in the business he develops and operates.
Routine work: an entrepreneur is more concerned with doing routine work and sometimes he may not know the important details of his own business.	**Specialist:** an intrapreneur acts as a specialist in his chosen field and serves as an outside professional.
Operation from outside: an entrepreneur always operates from outside. The owner is different and the enterprise he owns is different.	**Operation from inside**: But, an intraperneur operates from within the organization itself. He is a part and parcel of the organization.
Strong authorization: generally, an entrepreneur operates with a strong authorization back-up.	**Less authorization**: on the contrary, intraprneur is less authoritarian he is more “adaptable” in the organization.

1.4 Entrepreneurial traits, (what personality traits in the successful entrepreneurs)

Entrepreneurial traits

The successful entrepreneur can have a number of traits, which single them out.
Need for achievement – their social backgrounds may give them an overriding need to achieve. This can come from childhood deprivations, or competitive urges born of self-confidence.

Self-Determination – they probably have great faith in their ability to control their personal environment, rejecting too high an influence to chance or fate.

Desire for Independence – they wish for autonomy believing that independence of action is the only sure way to get what they need.

Innovation – they constantly market demands. Seek opportunities to be innovative in meeting market…
Whilst entrepreneurs may share some of these characteristics, no one single trait can be said to be the secret of entrepreneurial success.

1.5 Entrepreneurial functions

The main functions of an entrepreneur are as follows:

1. **Innovation**

An important function of an entrepreneur is “innovation”. Entrepreneur introduces new combinations in any branch of economic activity. Innovation implies doing new things or doing things that are already being done in new ways. It may occur in the following forms:

a. Introduction of a new product or new quality of an existing product.
b. Introduction of new methods of production or distribution
c. Opening of a new market
d. Conquest of a new source of raw materials
e. New form of organization of industry

Entrepreneurship is a creative activity and the entrepreneur introduces something new in any branch of economic activity.
According to Schumpter, the basic function of an entrepreneur was to innovate. He wrote “everyone is an entrepreneur only when he actually carries out new combinations and losses that character as soon as he has built up his business, which he settles down running it as other people run their business.”

Invention and innovation – though both inventions and innovation involve a tremendous amount of creativity, they are entirely different processes. On the other hand, innovation refers to the application of inventions and discovery to make new combinations and thereby produce satisfaction and profit. Inventions may facilitate innovation but an invention in itself is of little benefit to marking unless it is marketable. The innovator provides this missing link. An invention becomes an innovation only when it is embodied in a product or service that can be successfully sold in the market.

The resulting product of an inventor did not exist before. For example, mathematical calculators and microelectronics were inventions. On the other hand, innovation is a new combination of natural elements that results in a useful and commercially viable product. For example, microcomputer is an innovation made by combining the inventions mentioned above.

2. Marketing

Marketing is a distinguished unique function of the business. A business is set apart from all other human organizations by the fact that it markets a product or a service. A Church or an Army or a School or a State does not do any marketing of a product or service. Any organization that fulfils itself through marketing a product or a service is business. Any organization in which marketing is either absent or not relevant is not a business and should never be run as if it were one.

The first man to see marketing clearly as the unique and central function of the business enterprise and the creation of a customer as the specific job of management was Cyrus McCormick. The history books mention only that he invented a mechanical harvester. But he also invented the basic tools of modern marketing: marketing research and market analysis, the concept of market standing, modern pricing policies, the modern service salesman parts and service supply to the customers and installment credit. He is truly the father of business management. And he had done all this by 1850. It was not until fifty years later that he was widely imitated even in his own country.

The economic revolution of the American economy since 1900 has in large part been a marketing revolution caused by the assumption of responsibility for creative, aggressive, pioneering marketing by American management. Fifty years ago, the typical attitude of the American businessman toward marketing was still: The sales department will sell whatever the plant produces. Today it is increasingly the job of a business to produce what the market needs. But economists and government officials are just beginning to understand this.

In Europe there was no understanding that marketing is the specific business function until a few decades ago which was a major reason for the stagnation of the European economies at that time. Reaching full realization of the importance of marketing requires overcoming a deep rooted social prejudice against “selling” as ignoble and parasitical and in favor of “production” as gentlemanly with its resultant theoretical fallacy of considering production as the main and determining functions of a business.

A good example of this historical attitude toward marketing are those big Italian companies which have no domestic sales managers even though the home market accounts for 70% of their business.

1. **Innovative functions:** entrepreneurship is a innovative function as it involves doing things in a new and better way. Innovation may take several forms, e.g., a new product, a new source of raw material, a new market, a new method of production, not yet applied in a particular branch of manufacturing, etc.
2. **A function of risk-bearing**- risk is an inherent and inseparable element of entrepreneurship. An entrepreneur guarantees rent to the landlord, wages to employees, and interest to investors in the hope of earning more than the expenses. He assumes the uncertainty of future. In the pursuit of profits there is every possibility of loss.
   A business man, who simply behaves in a traditional ways, cannot be an entrepreneur. The entity is entrepreneurship if the entrepreneur makes decisions under uncertainty and has to take actions with unknown and unpredictable results.
3. **A function of high achievement:** McClellland stressed the need for achievement or achievement orientation as the most directly relevant factor for explaining economic behavior. The economic activity tends to possess people having high need for achievement which determines its success. Various studies on the psychological roots of entrepreneurship reveal the presence of a high achievement orientation among successful entrepreneurs. Such individuals believe that they can control their own lives as distinguished from a belief in luck.
4. **Economic activity:** Entrepreneurship is primarily an economic function because it involves the creation and operation of an enterprise. It is basically concerned with the production and distribution of goods and services.
5. **Purposeful activity:** the entrepreneur who creates and operates an emprise seeks to earn profits through satisfaction of needs of customers. Therefore, entrepreneurship is a goal-oriented activity.
6. **An organizing function:** an entrepreneur brings together various factors of production. He coordinates and controls the efforts of all the persons engaged in his enterprise. He harnesses land, labor,

capital and other resources for the benefit of mankind. Therefore, an entrepreneur is an organization builder.

7. **Gap filling function:** the gap between human needs and the available products and services gives rise to entrepreneurship. An entrepreneur identifies this gap and takes necessary steps to fill the gap. He introduces new products and services, new methods of production or distribution, new sources of inputs ad new markets of this purpose.
   Liebenstein identified two broad types of entrepreneurship. The routine entrepreneurship is associated with the managerial function of the business where as the new entrepreneurship is innovative in nature. The most significant feature of entrepreneurship is gap filling. It is the job of the entrepreneur to fill the gap or make up the deficiencies, which always exist in the knowledge about the production function. These gaps or deficiencies arise because all the inputs on the production function cannot be marketed. Some inputs like motivation and leadership are vague and their output is indeterminate. An entrepreneur has to Marshall all the inputs to realize final products. Thus, entrepreneurship is a function of input completing and gap filling. According to Liebenstein the supply of entrepreneurship is governed by inputs completing capacity and inadequate motivation state.
8. **Dynamic process:** entrepreneurship is a dynamic function. Entrepreneurs thrive on changes in the environment, which bring useful opportunities for business. Flexibility is the hallmark of a successful entrepreneur.

1.6 Kinds of entrepreneurs

The field of small business encompasses a great variety entrepreneurs and entrepreneurial ventures. This section examines this spectrum of entrepreneurs and entrepreneurship by identifying the varied types of people and firms that exist.

There are various ways by which entrepreneurs have been classified.

Clarence Danhof's Classification

In the initial stages of economic development, entrepreneurs tend to have les initiative and drive. As development proceeds, they become more innovating and enthusiastic. Similarly, when entrepreneurs are shy and humble the environment is underdeveloped. Business environment becomes healthy and developed when entrepreneurs are innovating. Basing on this, Clarence Danhof, in his study of American agriculture, classified entrepreneurs' into four categories.

1. **Innovating entrepreneurs**: Innovative entrepreneurship is characterized by aggressive assemblage of information and the analysis of results derived

from sound combination of factors. An innovating entrepreneur is one who introduces new goods, inaugurates new method of production, discovers new market and reorganizes the enterprise. It is important to note that such entrepreneurs can work only when a certain level of development is already achieved, and people look forward to change and improvement. Generally, they are typical of developed countries. A country with little or no industrial tradition can hardly produce role in the rise of modern capitalism, through their enterprising sprit, hope of money making, abilityto recognize and exploit opportunities, etc. the innovating entrepreneur does not invent rather commercializes the inventions or implements the inventor's ideas.

2. **Adoptive or imitative entrepreneurs:** these are characterized by readiness to adopt successful innovations inaugurated by successful innovating entrepreneurs. They lap up innovations originated by innovating entrepreneurs. Imitative entrepreneurs do not innovate the changes themselves, they only imitate techniques and technology innovated by others. Such types of entrepreneurs are particularly suitable for the underdeveloped regions for bringing a mushroom drive of imitation of new combinations of factors of production already available in developed regions.

   In highly backward countries there is shortage of imitative entrepreneurs also. People who can imitate the technologies and products to the particular conditions prevailing in these countries are needed.

   Imitative entrepreneurs face lesser risks and uncertainty than innovative entrepreneurs. While innovative entrepreneurs are creative, imitative entrepreneurs are adoptive.

3. **Fabian entrepreneurs**: entrepreneurs of this type are very cautious and skeptical while practicing any change. They have neither the will to introduce new changes nor the desire to adopt new methods innovated by the most enterprising entrepreneurs. They imitate only when it becomes perfectly clear that failure to do so would result in a loss of the relative position in the enterprise. They are lazy and shy and lack the will to adopt to new methods of production. Their dealings are determined or dominated more customs, religions, tradition, and past practices. They are not much interested in taking risk and they try to follow the footsteps of the predecessors.
4. **Drone entrepreneurs:** drone entrepreneurs is characterized by a refusal to adopt and use opportunities to make changes in production formulae even at the cost of severely reduced returns relative to other like producers. Such entrepreneurs may even suffer losses but they are not ready to make changes in the existing production methods. They struggle to exist, not to grow. Thus, they are laggards as they continue to operate in the traditional way and resist changes. They blindly follow traditional methods of production even when it causes loss to him.

   When their product loses marketability and their operations become uneconomical they are pushed out of the market. They are

conventional in the sense that they stick to conventional products and ideas.

Some more categories of entrepreneurs are given below:

1. **Women entrepreneurs**

The number of women becoming entrepreneurs, in USA, has risen dramatically during the last two decades. News papers and business magazines frequently feature women as successful entrepreneurs. Between 1982 and 1987, the number of women-owned businesses increased by 57.4 percent with recipients of these businesses rising by 81.2 percent. A study by economist David Birch, released in 1992, reported than women owned 28 percent of the business in U.S. and that they employed 10 percent of the country's workers. Women's businesses ownership has been expanding much more rapidly than men's business ownership, but women are expanding from a smaller base of ownership.

Generally, where the supporting conditions have been favorable, there is a phenomenal increase in the number of self-employed women (referring to women entrepreneurs) in the advanced countries of the world. To quote, women own 20 percent of all businesses in France, 25 percent in United States, and 33 percent in Canada. Whereas it seems less in developing countries, such as India 9.01 percent of the total 1.70 million entrepreneurs during 1988-89. However, owning to the various governmental schemes and efforts of various voluntary organizations, the number of women entrepreneurs in India is growing but slowly.

With the spread of education and awareness, women entrepreneurs in India shifted from the extended kitchen activities, i.e. 3Ps (pickles, powders, and paddad) to the higher level of activities, i.e., 3Es, viz., Engineering, Electronics and Energy. Although the number of such units to manufacture solar cookers (Gujarat), small foundries (Maharashtra), Capacitors (Orissa) and electronic ancillaries (Kerala).

In India, since the inception of the National Awards to Small Entrepreneurs instituted in 1983, 10 women entrepreneurs have received special recognition awards. They attributed their success, to their untiring hard work, perseverance, tenaciousness, determination, confidence in them and most importantly, their compelling urge of wanting to do something positive in their lives. Added to these was a man behind every successful women.

Women entrepreneurs obviously face problems common to al entrepreneurs. However, they must also contend with difficulties associated with their newness in entrepreneurial roles. Lack of access to credit has been a problem frequently cited by women who enter business. This is a troublesome area for most small business owners, but many women entrepreneurs feel they carry an added burden of discrimination. Another barrier for some women is the limited opportunity they find for business relationships with others in similar positions. It takes time and effort for

them to gain full acceptance and to develop informal relationships with others in local, mostly male, business and professional groups.

General problems	Problems specific to women
• Raw material problems • Marketing problems • Problem of finance • Infrastructural problems • Problem of skilled manpower • Delays in promotional procedures • Cumbersome difficulties in availing of government concessions and subsidies.	• Lack of need achievement, economic independence and autonomy. • Absence of risk-bearing capacity • Lack of education skills • Male dominating society • Lack of business information experience • Heavily involved in family problems • Lack of viable concept • Social stigma attached to certain vocations.

2. Founders and other Entrepreneurs

Although categories tend to overlap, entrepreneurial leadership may be classified into three types:

a. Founders
b. General managers, and
c. Franchisees

a. Founding entrepreneurs

Generally considered to be the pure entrepreneurs, founders may be inventors who initiate on the basis of new or improved products or services. Founders refer to entrepreneurs who bring new firms into existence. They may also be artisans who develop skills and then start their own firms. Or backgrounds, who draw upon the ideas of others in starting new firms. Whether acting as individuals or in-groups, these people bring firms into existence by surveying the market, raising funds and arranging for the necessary facilities. After the firm is launched, the founding entrepreneurs may preside over the subsequent growth of the business or sell out and move on to other ventures.

b. General Managers

As new firms become well established, founders become fewer innovators and more administrators. Thus, we recognize another class of entrepreneurs called general-managers. General Manager presides over the operation of successful ongoing business firms. They manage the week-to-week and month-to-month production, marketing, and financial functions of small firms. The distinction between founders and general managers is

often hazy. Nevertheless, it is helpful to distinguish those entrepreneurs who found and substantially change firms (the movers and shakers) from those who direct the continuing operations of established firms.

c. Franchisees

It is helpful to recognize a third category of entrepreneurs that of franchisees. Franchisees differ from general managers in the degree of independence. Because of the constraints and guidance provided by contractual relationships with franchising organizations, franchisees function as limited entrepreneurs.

3. High growth and low growth firms

Small business ventures differ greatly in their potential for growth and profits. Some create millionaires, while others produce less spectacular results. To account for these differences, we may distinguish forms according to the following categories.

a. Marginal firms
b. Attractive small companies, and
c. High potential ventures

a. Marginal firms

Marginal firms are only small firm that provides insignificant profits to its owner(s). very small-dry cleaners, independent garages, beauty shops, service stations, appliance repair shops, and other small firms that provide very modest returns to their owners are marginal firms. We do not call them marginal because they are in danger of bankruptcy. Some marginal forms, it is true, are on thin-ice financially, but the distinguishing feature of their limited ability to generate significant profits. Entrepreneurs devote personal effort to such ventures and receive a profit return that does little more than compensate them for their time. Part-time businesses typically fall into this category of marginal firms.

b. Attractive small companies

Are nay small firms that provide substantial profit to its owners? In contrast to marginal firms, numerous attractive small firms offer substantial rewards to their owners. Entrepreneurial income from these ventures may easily range from $50, 000 to $200,000 annually. These are the strong segment of small business the good firms that can provide rewarding careers.

c. High-potential ventures

Are firms that have great prospect for growth. Frequently these are also high-technology ventures. At the time of the firm’s founding, the owners often anticipate-rapid growth, a possible merger, or going public within a few years. Some of the spectacular examples within recent years include Microsoft, Wal-Mart, and McDonalds. Entrepreneurial ventures of this type

appeal to many engineers, professional managers and venture capitalists who see the potential rewards and exciting prospects.

4. Artisan entrepreneurs and Opportunistic entrepreneurs

Perhaps because of their varied backgrounds, entrepreneurs display great variation on their styles f doing business. They analyze problems and approach decision-making in drastically different ways. Norman R. Smith has suggested two basic entrepreneurial patterns:

a. Artisan entrepreneurs, and
b. Opportunistic entrepreneurs

a. Artisan entrepreneurs

According to Smith the artisan entrepreneur is a person who starts business with primarily technical skills and little business knowledge. Artisan entrepreneur is limited to technical training. Such entrepreneurs have technical job experience, but they lack good communication skills. Their approach to business decision making is characterized by the following features:

- They are paternalistic (this means they direct their business much as they might direct their own families)
- They are reluctant to delegate authority
- They use few (one or two) capital sources to create their firms.
- They define marketing strategy in terms of the traditional price, quality and company reputation.
- Their sales efforts are primarily personal
- Their time orientation is short, with little planning for future growth or change.

The mechanic who starts an independent garage and the beautician who operates a beauty shop illustrate the artisan entrepreneur.

b. Opportunistic entrepreneurs

Smith's definition of the opportunistic entrepreneur is one who has supplemented technical education by studying such non-technical subjects as economics, law of English. Opportunistic entrepreneur- is an entrepreneur who enters business with both sophisticated managerial skills and technical knowledge. Opportunistic entrepreneurs avoid paternalism, delegate authority as necessary for growth, employ various marketing strategies and types of sales efforts, obtain original capitalization from more than two sources, and plan for future growth. An example of the developer who uses a relatively sophisticated approach to management. Because of the complexity of the industry, successful contractors use careful record keeping, proper budgeting, precise bidding and systematic marketing research.

5. Entrepreneurial teams

In the discussion so far, we have assumed that entrepreneurs are individuals. And, of course, this is usually the case. However, the entrepreneurial team is another possibility that is becoming popular,

particularly in ventures of substantial size. An entrepreneurial team is formed by bringing together two or more individuals to function in the capacity of entrepreneurs. Entrepreneurial team refers to two or more people who work together as entrepreneurs.
By forming a team, founders can secure a broader range of managerial talents than is otherwise possible. For example, a person with manufacturing experience can team up with a person who has marketing experience. The need for such diversified experience is particularly acute in creating new high-technology businesses.

6. Pure, Induced, Motivated and Spontaneous entrepreneurs

Motivation is the force that influences the efforts of the entrepreneur to achieve his/her objectives. An entrepreneur is motivated to achieve or prove his excellence in job performance. He is also motivated to influence others by demonstrating hs power thus satisfy his ego. Hence, according to the motivation of entrepreneurs, we can broadly classify these entrepreneurs as follows:

a. Pure entrepreneur
b. Induced entrepreneur
c. Motivated entrepreneur
d. Spontaneous entrepreneur

a) Pure entrepreneur

A pure entrepreneur is an individual who is motivated by psychological and economic rewards. He undertakes an entrepreneurial activity for his personal satisfaction in work, ego, or status.

b) Induced entrepreneur

Induced entrepreneur is one who is induced to take up an entrepreneurial task due to the policy measures of the government that provides assistance, incentives, concessions and necessary overhead facilities to start a venture. Most of the entrepreneurs are induced entrepreneurs who enter business due to financial, technical and several other facilities provided to them by the state agencies to promote entrepreneurship. A person with a sound project is provided package assistance to his project. Today, import restrictions, and allocation of production quotas to small units have induced many people to start a small-scale industry.

c) Motivated entrepreneur

New entrepreneurs are motivated by the desire for self-fulfillment. They come into being of the possibility of making and marketing some new product for the use of consumers. If the product is developed to a saleable stage, the entrepreneur is further motivated by reward in terms of profit.

d) Spontaneous entrepreneur

These entrepreneurs start their business out of their natural talents. They are persons with initiative, boldness, and confidence in their ability, which motivate them to undertake entrepreneurial activity. Such entrepreneurs have a strong conviction and confidence in their ability.

7. First-generation, Modern, and Classical entrepreneurship

Depending up on the stage of development entrepreneurs may also be classified as:

i. First generation entrepreneur
ii. Modern-entrepreneur
iii. Classical entrepreneur

i) First generation entrepreneur

A first generation entrepreneur is one who starts an industrial unit by means of an innovative skill. He is essentially an innovator, combining different technologies to produce a marketable product or service.

ii) Modern-entrepreneur

A modern entrepreneur is one who undertakes those ventures which go well along with the changing demand in the market. They undertake those ventures which suit the current marketing needs.

iii) Classical entrepreneur

A classical entrepreneur is one who is concerned with the customers and marketing needs through the development of self-supporting ventures. He is a stereotype entrepreneur whose aim is to maximize his economic returns at a level consistent with the survival of the firm with or without an element of growth.

8. Ontreprenuer/Netpreneur

In these days information technology, one can become an entrepreneur very easily by launching on-line business. The internet has changed the concept of everything including the business. It has reduced the task of entering into a business. With a meager investment, any person can set up a website and look for potential customers in the line of business or an innovation through the internet has been called by Adam Bryant as the “Ontrepreneur” or “on-line entrepreneur”. He can also be called ‘Netpreneur’.

1.7 Entrepreneur Vs Inventor

An entrepreneur and an inventor both have their own financial rewards. Being an inventor takes a lot of creativity and innovation to be able to come up with an idea that no one has thought of yet; a unique idea for a product or service that has never been introduced in the market; an idea that could be the next big thing. An entrepreneur, meanwhile, is a business-minded person that can use existing products and services and customize them according to the specific needs of target market of his business. The entrepreneur will put his own brand onto the product or service and make it uniquely his own.

Being an inventor, your ideas could be of use to consumers in the commercial market. Companies would be willing to buy that idea and make it their own for reproduction. Ideas can be licensed or be rented by many companies. When you come up with novel idea, protection for the idea can

then be filed in the right government agency. You can then look for a company that will be interested in your idea and will greatly benefit from it.

If a certain company has shown interest, the inventor can then personally contact that company and set up a meeting. If the inventor feels that the relationship with the company is comfortable enough and the product idea will satisfy a need that has been identified in the market, the idea will then be under license to that company. The inventors can just a collect a royalty from that idea every quarter of the year. There are some licensed ideas that lasted for many years with the same company while others can be short-lived. Licensing product ideas just deal with the numbers. There is not a single company or person that can have all the ideas. Coming up with an idea or inventing is a limitless activity. The trends for many companies have been to look for licensed product ideas from inventors that are not employed by their company.

Being an entrepreneur can also be very lucrative. An inventor can decide to market his own idea if he has the resources to do so. Turning that idea into a reality and a business can be certainly a challenge. For the first time entrepreneur, a simple idea might be a good way to start because this would not cost that much money to create.

An entrepreneur is in control of all his ideas and the way in which he brings those ideas to life and markets them. An inventor, however, surrenders much of the control of the idea when it is under license to a company. Running your own business requires complete control. You are in charge of every aspect of the product, from production, marketing to distribution. There are financial risks involved in venturing into a business. There is little risk in the licensing of an idea. One can only gain from it. There is no big investment required in being an inventor.

It is really up to you if you will consider being an inventor or an entrepreneur. You have to weigh all the advantages and disadvantages before you decide on the path to take. What is important is that you will be able to convert your idea into something useful and at the same time reap financial rewards for it.

An inventor is an individual who creates something for the first time. The typical inventor, who is motivated by her work and personal ideas, tends to be well educated-often with postgraduate degree. She has family and work experience that contributes to creative development and freethinking. She is also a problems solver who is able to break complex problems into simple ones and tolerate ambiguity and uncertainty. She is highly self-confident and willing to take risks. Moreover, unlikely to regard money as a measure of success, she places high emphasis on being an achiever.

From the above profile it can be seen that the typical entrepreneur differs considerably from the average inventor. Unlike the investor who is in deep love with the inventions and unenthusiastically modifies the invention to make it commercially feasible, the entrepreneur falls in love with the new venture and takes all the risks to make sure it survives and grows. To develop the inventor's work into a new venture, it often requires the expertise of an entrepreneur.

1.8 ***Entrepreneurial process***

The prospective entrepreneur, in order to establish and run a successful business, goes through a process known as entrepreneurial process. During this process the entrepreneur carries out a number of activities that lead to the successful establishment and management of the business. The entrepreneurial process, which is made up of related activities, consists of the following phases.

1. Identifying and evaluating a business opportunity
2. Developing the business plan
3. Determining the resources required for the business and
4. Managing the resulting enterprise

These activities overlap, meaning an activity will be started before the one that has already been started is completed. Therefore, the entrepreneur may need to consider the third or the fourth phases while still carrying out phase one. For instance, to evaluate the profitability of the business opportunity well, the entrepreneur need to know the cost of the resources required to establish the business.

Identifying and evaluating the business opportunity

This phase is the first and the most difficult since most business ideas do not suddenly appear. Generally a new business opportunity may be the result of a technological change, market shift, government regulation, or competition. Good business opportunities are often the results of the entrepreneur being alert to her environment of extra effort in establishing opportunity identification mechanisms. Most entrepreneurs do not have formal mechanisms to identify new business opportunities. However, there are some sources such as consumers, members of distribution channels, and technical people that are generally fruitful. Often, the most and best business ideas come from customers. Complaints and remarks such as 'I wish there were a better product…..' or 'I wish I could find a product that is specially made for…' may result in the inception of a new business idea and a new product.

Distribution channel members such as whole sellers, distributors and retailers are also good sources of business ideas. Their proximity to consumers of the product gives them the opportunity to better see a market

gap or a demand for a better product. Technical people are also good sources of ideas for a new business. Technical individuals, while working on various projects, may come across a new or better way to manufacture a product. Regardless f its source, however, a newly generated business idea must be carefully examined. This evaluation of the business idea is perhaps the most critical of the entrepreneurial process, as it is the phase in which the profitability of the business idea will be determined.

This identification and evaluation phase deals with the assessment of the creation and length of the opportunity, its real and perceived value, its risks and returns, its real and perceived value, its risks and returns, its differential advantages s competitive environment, and its fit with the personal skills and goals of the entrepreneur. Here it is very important to note than the opportunity must also fit the personal interests of the entrepreneur. A person, without the necessary interest or skill to start a new venture, may not become a successful entrepreneur even if she has a brilliant business idea.

At this particular phase, as a matter of formal procedure, the entrepreneur may prepare an opportunity assessment plan. The plan, also referred to as opportunity analysis, focuses on the issues that enable the entrepreneur to make the decision whether to act on the opportunity or not. Focusing entirely on the opportunity, this plan includes a description of the product or service; an assessment of the entrepreneur, the team and the opportunity; specifications of all the activities and resources needed to translate the opportunity into a viable business venture; and the sources of capital to finance the establishment of the venture as well as its growth. The assessment of the opportunity is not an easy task, however. In fact, it is the most difficult and critical aspect of the opportunity analysis.

Through the assessment analysis, the entrepreneur answers questions such as ‘What market need does the product satisfy?’, ‘What resources from which sources will be required to convert the business opportunity into a business venture?’, ‘Is the entrepreneur fit to act on the opportunity?’, ‘How fierce is the local and international competition?’

Remember that a business idea is not a business opportunity until it is assessed objectives and judged to be feasible. You may wish to choose one of the ideas that seem most promising for more detailed study. Trying to consider too many would make your time, energy and attention devoted to each too little. At the same time, if you focus on only on one business idea, you are more likely to fall in love with it, and could lose your objectivity.

Developing a business plan

Once a business idea is selected, the concept must be sharpened by an in depth planning process. The result of this step is a comprehensive business plan-the “blueprint” for the implementation process.

A business plan is a document the entrepreneur prepares before going to the implementation stage. It has details in every aspect of the business the entrepreneur aspires to establish: description of the business, and the marketing, financial, organizational and operational plans necessary for the foundation of the venture. The business plan is also useful to develop the opportunity and determine the resources required for the business and their sources. In addition, the plan is helpful to successfully manage the resulting venture. The business plan will be dealt in greater depth in chapter 4. Developing the business plan is often difficult because the required resources for the plan may not be readily available and/or the entrepreneur may not have rich experience in business plan preparation.

Determining the required resources

The entrepreneur needs to identify the resources require for the business before embarking on the business opportunity. The entrepreneur starts this phase with an assessment of her present resources. Then, she carefully identifies all the resources required to get the business on its feet and run it successfully. Here, the entrepreneur must be careful not to undertake the quality and quantity of the required resources. She also needs to classify the required resources into two: the ones that are vital and the ones that are just helpful. It is also important to evaluate the impact of insufficient or inappropriate resources on the business. The next step will be to acquire the needed resources in the right quality and quantity on a timely basis. The resources needed may be finance (money), machinery, raw materials etc…

Managing the Venture

Once the required resources for the business have been acquired, the entrepreneur will deploy them through the implementation of the business plan. At this stage, the entrepreneur examines the operational problems of the growing enterprise, a task that involves the implementation of an effective management approach and structure. An effective control mechanism also needs to be set up in order to identify and tackle emerging problems and challenges on time. Some entrepreneurs find managing and leading the venture they created very difficult-a distinction between entrepreneurs and managers.

1.9 Challenges of entrepreneurs

The entrepreneur faces problems perhaps starting from the day she/he identifies the business idea. In fact, problems follow the entrepreneur like a shadow. Given the limited information and experience of the entrepreneur, even the simplest challenge may emerge as a big problem specifically at the initial stage.

The challenges faced by the entrepreneur can be classified as internal and external

Internal problems	External problems

• Choice of business idea • Financial limitations • Inadequate knowledge and experience • Poor project planning • Faulty planning: Lack of strategies and vision • Poor production and marketing • Poor product quality • Labor problems • Lack of vertical and horizontal integration • Inadequate underutilization • Inadequate connection	• Infrastructure • Finance • Administrative hurdles and corruption • Tax • Raw material availability • Environmental regulation • Inspection • Technology • Government policy • Competition • Culture

Review questions

1. Define the term entrepreneur and intrapreneur.
2. Distinguish between Fabian entrepreneur and Drone entrepreneur.
3. Who is a cognitive entrepreneur?
4. Distinguish between an innovative entrepreneur and an adoptive entrepreneur.
5. What is the most significant reason for following an independent business career by an entrepreneur whom you know best?
6. In view of the fact that entrepreneurs must satisfy customers, employees, bankers, and other, are they really independent? Explain the nature of their independence as a reward for self-employment.
7. What is shown by the studies of David C. McClelland regarding an entrepreneur's need for achievement?
8. On the basis of your own knowledge, can you identify a "foreign refuge" who is an entrepreneur?
9. What is the social implication of the growth trend in women's entrepreneurs?
10. What is the difference between a marginal firm and a high potential venture?
11. Distinguish between a craftsman entrepreneur and an opportunistic entrepreneur.
12. Why is the period from the late 20s to the early 40s in a person's life considered to be the best time for becoming an entrepreneur?

CHAPTER TWO

SMALL BUSINESS: VITAL COMPONENT OF THE ECONOMY

Objectives of the chapter

At the end of this chapter, students will be able to;

- ♣ Define small business.
- ♣ Describe the main characteristics of small scale industries.
- ♣ Understand the role of small businesses to the economy of a country.
- ♣ Indentify the problems of Ethiopian small businesses.
- ♣ Indentify the forms of business organizations and the legal issues of entrepreneurs.

Chapter Description

This chapter deals about small businesses and to what extent these small businesses are helpful for the poor and developing countries economy and economic, social and political aspects. Furthermore the chapter discusses about small business failure factors, the main problems in Ethiopian small businesses, forms of business organizations and the legal issues that must be considered for entrepreneurs.

Contents

2.1. Definition of small business
2.2. Characteristic of small scale industries
2.3. Why are small businesses Important to the economy?
2.4. Economic, Social and Political Aspects of small business enterprise
2.5. Risks and causes of failure associated with small business
2.6. Problems in Ethiopia small business
2.7. Forms of business of organization
2.8. Legal issues for the entrepreneur

2.1Definition of small business

Defining small business is not as easy as it looks: we have different definitions depending on the size of the industry we are talking about, the purpose of the definition, and the country the definition is applicable to. The variables writers use in defining small businesses include: size of working

capital, number of employees, asset size, annual sales, market share, and operational domain. For the sake of discussion, we adopt the following definition. Small business is a business which employs less than 100 employees, is owned by one or few individuals, with the exception of the marketing function has geographically localized operations, and does not dominate its industry.
Having the above definition in mind, businesses can be found in different industries but they differ in their nature and importance from industry to industry which include:

a. Retail industry: Drug stores, clothing stores, auto accessories dealers, appliance dealers, book stores, music stores…..etc.

b. Service industry: accounting firms, advertising agencies, managerial consultants, barber and beauty shops, dry cleaners, travel agencies… etc.

c. Finance insurance and real estate industries: insurance agencies, real estate brokerage firms, pawn brokers, small banks, loan companies… etc.

d. Transportation and other public utilities: Taxi cab companies, community news paper publishers, local radio and television stations…etc

e. Manufacturing industries: Bakeries, sawmills, toy factories, job printing shops, shoe factories, ice cream plants, furniture manufacturing plants…etc.

In terms of entrepreneurship, small business is a very personal approach to creating new enterprises. And small businesses usually have limited growth opportunities and operate in a community atmosphere.

2.2Characteristic of small scale industries

1. **Closely held:** the unit is generally a one-man show. Even if a unit is run by a partnership concern/company, the activities are mainly carried out by one of the partners/directors and the others are merely sleeping partners/directors who generally assist in providing finance.

2. **Personal character**: there is close personal contract/supervision of all activities, say purchase, production labor, and sale of products. The owner himself is generally the manager. Therefore, these firms are generally managed in a personalized manner. The owner has firsthand knowledge of whatever is going on in the business. He actively participates in all aspects of business decision making.

3. **Limited scale operations**: a small scale industrial unit has a lesser gestation period. A small scale unit has a limited share of a given market. The size of the firm in the industry is small.

4. **Indigenous resources**: small-scale industries can be easily located anywhere subject to availability of raw materials, labor, finance, etc. small scale units use local resources. Therefore, they have decentralized or dispersed location.

5. **Labor intensive**: they are generally more labor oriented with comparatively smaller capital investment then the large units. The capital investment is limited due to the use of simple technology. They require large amount of working capital to meet their day-to-day expenses.

6. **Local area of operation**: the operations of a small scale unit are generally localized. However, market for its products need not be local. It may cater to local and regional demands or its products may even be exported.

7. **Simple organization**: a small business unit has few or no layers of management. Division of labor or specialization is low and the resources are limited.

2.3 Why are small businesses Important to the economy?

The purpose is to understand the contribution made by small business as part of our total economic system. Small firms operate in all industries, but they differ greatly in their nature and importance from industry to industry. In thinking about their economic contribution, therefore, we first need to identify the eight major industries (as classified by the U.S. department of commerce) and note the types of small firms that function in these industries. These eight major industries and examples of small firms in each are as follows:

I. Wholesale Trade Wholesale drug companies Petroleum bulk stations	V. Finance, Insurance, and Real Estate Local insurance agencies Real estate brokerage firms
II. Construction General building contractors Electrical contractors	VI. Mining Sand and gravel companies Coal mines
III. Retail Trade Hard ware stores Restaurants	VII. Transportation and public utilities Taxi-cab companies Local radio stations

IV. Services Travel agencies Beauty shops	VIII. Manufacturing Bakeries Machine shops

As you can see in the above table, the vast majority of the 3.8 million businesses are small. 98% have fewer than 100 employees.

Although small businesses pose a number of challenges to the entrepreneur and have certain limitations, a countries economy cannot superior over large ones in certain aspects of business activities.

First, let's try to see why it is advisable for an individual to start when embarking on entrepreneurial ventures.

1. **Providing job opportunities:** this is one way in which small businesses contribute to the country's economy. In fact, in most countries, the number of new jobs created by small business is significantly higher than created by large businesses. For example, in the US, 50% the employment comes from small businesses and each year small businesses account for about 80% of the new job created.

2. **Introducing innovations:** new products which originate in the research laboratories of big businesses make a valuable contribution to our standard of living. There is a question, however, as to the relative importance of big businesses in achieving the truly significant innovations. Usually, the research departments of big businesses tend to emphasize the improvement of existing products. Records show that many scientific breakthroughs originate with independent inventors and small organizations.

3. **Stimulating economic competition:** small business by definition is one that does not dominate its industry, and competition will be closer to perfection when the market price and supply when operating individually.

4. **Aiding big businesses:** the fact that some functions are more expertly performed by small businesses enables small businesses to contribute to the success for larger ones. Especially, there are two types of business activates that are performed by small businesses inexpensive consumer products find it desirable to own resale and retail out lets. Second, supply functions. Most small businesses act as suppliers and sub contractors for large firms.

5. **Producing goods and services:** we depend highly on small businesses for the provision of most goods and services we need in our lives. In fact, if it was not for small businesses, we would have not

been able to find the goods and services we need at the time we need them, in a convenient place, and at the quantity we prefer.

In addition to the above general advantages small businesses offer a country's economy, they have certain benefits to the individual entrepreneur. These include:

- Small businesses require less time, energy and financial resources to establish
- They also provide the entrepreneur with greater autonomy, and independence-because the money needed to start small businesses is relatively small, the entrepreneur can raise most of it by him/herself without relinquishing significant onrushing interest and control.
- In addition to these, small businesses help the entrepreneur develop his skill in running organizations as he is expected to perform different kinds of activities concerning the business. These include; business planning, investment and finance, customer relations, personnel and human resources, cash control and book keeping, inventory control, purchasing, marketing and sales, and leadership.

2.4 Economic, Social and Political Aspects of small business enterprise

Small businesses (enterprises) have to play a vital role in Ethiopian economy. They need a strong support on socio-economic and political grounds.

2.1.1. Socialistic Idea (The equality Argument)

Our goal is being the establishment of a socialist pattern of society. Our objectives are equitable distribution of wealth and decentralization of economic power. The benefits of industrial growth should be shared by as many people as possible and should improve the general standard of living. Proliferation of small enterprises will go a long way in achieving these objectives.

According to this argument unregulated growth of large scale industries results in concentration of economic power in a few hands and consequently grosses inequalities in the distribution of income and wealth in the country. On the other hand, income generated in large number of small enterprises is dispersed more widely and its benefit is derived b a large population. This is due to wide spread ownership and decentralized location of small scale units. In this way small scale enterprises bring about greater equality of income distribution. It is also argued that most of the small scale units are either proprietary or partnership concerns. As a result relations between workers and employers are more harmonious in small enterprises than in large enterprises. Critics of small business argue that due to absence of strong trade unions in small units, the employer can more easily exploit workers. Wages and other benefits in the small firm are lower than in large

firms. By paying low wages, small business enterprises generate less savings and less axes and there by result in low growth potential.
However, in underdeveloped countries workers prefer a low paid job to no job at all. In the absence of small enterprises workers may have to lose even the small wage which they hope to get. Moreover, wage rates in small firms can be improved through labor laws and trade unions. Small enterprises also encourage competitive spirit and generate the impulse of self development.
The state of Ethiopia where there is a large network of small scale enterprises, with comparatively less investments in the large scale sector, the general standard of living is much higher than in the states where heavy investments have been made in large scale industries.

2.1.2. Less capital and more labor (The Employment Argument)

The main problem is that we have vast manpower but inadequate capital, which has resulted in increasing unemployment. This is unlike in situation in western countries where manpower is limited but capital resources are enormous. Planners have realized the necessity of encouraging small industries because they require less capital but generate more employment. It is estimated that through the net-out per worker n large and medium industries is more than twice as compared to that in small scale industries, the investment of capital per worker is about seven times.
The small-scale sector has the capacity to generate a much higher degree of employment than the large-scale sector. For example according to the data collected by the in dial development commissioner of small industries states that-the fixed investment in plant and machinery per worker in the small-scale sector is about Rs. 3000 and Rs. 20,000 in the large scale sector. The present inflationary trend is largely due to shortage of goods. More production needs more capital in such a situation. These small industries will stand in good position because they are less capital intensive and more employment oriented.
The argument is based on the assumption that small scale industries are labor intensive and thus create more employment per unit of capital. It is said that employment generation capacity of small sector is eight times that of the large scale sector. According to prof. P.C. Mahalanobis, household or cottage industries require very little capital. With any given investment employment possibilities would be ten or fifteen or even twenty times greater in comparison with corresponding factory industries.

2.1.3. Removing regional imbalance (The decentralization argument)

Another problem is the continuous shifting of people from rural to urban areas which causes over-crowding in cities with slum conditions due to lack of social and medical amenities which require heavy investment. This problem can be solved inducing people to set up small industries in rural areas.
The prolific setting up of agro-based industries will go a long way in creating a balance in our country’s economy. In order that industrialization

may benefit the economy of the country as a whole, it is important that disparities in the matter of development between different regions should be progressively reduced.
Large scale industries have the tendency to concentrate in big cities. As a result semi urban and rural areas remain deprived of the benefits of industrialization. Moreover, undue concentration of large industries in urban areas creates several problems. E.g., pollution, slums, shortage of civic facilities, etc. due to employment opportunities in the countryside, people migrate in large number to big cities. Small scale units can be located in rural and semi urban areas to reduce regional disparities.

2.1.4. Creating self employment opportunities

In India, since independence it has had a steady rise in the number of qualified engineers seeking suitable jobs. But having in adequate adventures, they can have self-employment by setting up small industries with the help and expertise proved by the government and other agencies. Main bank and have several industrial corporations, here, have arranged special training programs for young entrepreneurs, who can easily set up their own units with package assistance from the governments.

2.1.5. Ancillary Function

Many small-scale industries units supply and accessories bigger industries. This ancillary function involves specialization in specific areas and results in greater profitability. The government has, therefore, relaxed the ceiling of investment in plant and machinery for ancillary unit.

2.1.6. Export promotion

Small-scale industries are now a day opening up fresh avenues in the export market in our world. Realizing the importance of the small-scale sector in the economy the Ethiopian government has adopted several measures to speed up the growth for small industries.

2.1.7. Supply of critical raw materials

The government has also liberalized the importer to ensure regular supply of raw materials to small industrial units, and devised a more efficient and consistent system of distribution of critical raw materials.

2.5 Risks and causes of failure associated with small business

Although a lot of new small businesses are established in most countries, the success rate is very minimal. This can be attributed to a lot of factors, which can be generally classified in to two categories:

Internal factors of failure and personal factors of failure

Economic business cycles, fluctuating interest rates, interrupted suppliers, labor market trends, inflation, government regulations and unstable financial markets are some of the external factors that might bring about small business failure. Although all businesses /small or big/ are subject to these risks, their effect on small businesses is far more serious than any other business. This is because the resources a small business owner

controls are very limited which makes it very difficult to deal with these situations.
On the other hand there certain problems that can be attributed to personal weaknesses and limitations of the entrepreneur. These include:

- **Inexperience:** too often, entrepreneurs launch their enterprises without having sufficient experience to succeed. Inexperience can be translated to mean a lack of technical skills of management acumen.

- **Arrogance:** many small business persons-particularly inventors and innovative entrepreneurs with new products become consumed with their own brilliance, convinced beyond reason (often without market research) that…

- **Their bright idea will change the world:** it is got to see! Their arrogance will not allow them to take advice from others.

- **Mismanagement:** humble entrepreneurs steeped in experience can still go under simply mismanagement of resources; they simply make bad decisions in critical situations. These may include:

- **Over investment on fixed assets:** when starting or expanding a business, it is tempting to buy facilities and equipments rather than lease or subcontract. Everyone likes to own assets, but greater investment on fixed assets means less flexibility to adjust to adverse conditions.

- **Poor inventory control:** purchasing too much inventory increases the risk of low turnover and obsolescence. Having too little inventory undermines customer satisfaction and sales. Buying the wrong inventory, or buying at the wrong time, evaporates cash. In each scenario, the business tries up high powered cash in non-earning assets, and the inventory items can rarely by disposed of for more than a fraction of their costs in an emergency. The result is that a business “purchases” itself in to insolvency.

- **Poor business philosophy:** an unfortunate aspect of many business failures is that too often individual owner’s priorities get in the way of sound business practices. In the least obtrusive way, entrepreneurs may not be fully committed to the long hours required to make a venture success full.

- **Lack of Planning:** most entrepreneurs frequently underestimate the importance of planning in business success. However,, not planning means not anticipating future problems and challenges and not being prepared for them in advance. This surely leads the entrepreneur in to making mistakes and facing problems which could have been easily avoided though sound planning.

2.6 Problems in Ethiopia small business

Small scale industries have not been able to contribute substantially as needed to the economic development particularly because of financial, production, and marketing problems. These problems are still major handicaps to their development lack of adequate finance and credit has always been a major problem of Ethiopian small business. Small-scale units do not have easy access to the capital market because they mostly organized on proprietary partnership basis 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 that their surpluses which can be utilized to repay loans are negligible. Because of their size and partly because of the fat limited profit, they search for funds for investment purposes. Consequently, the approach moneylenders who charge high rate of interest hence small enterprises continue to be financially weak.

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. Furthermore, the techniques of production, which these enterprises have adopted, are usually outdated. Because of their poor financial position they are not able to buy new equipment consequently their productivity suffers. Besides, many small business enterprises are suffering with the problem of marketing their products.

It is only by overcoming all these constraints that small enterprises can hope to make their enterprises successful.

Management practice in Ethiopian Small Business

Small-scale industries sector occupies a strategic position of unique importance in the Ethiopian economy. Today, the village and small-scale industries sector roughly account for roughly about one-half of the total industrial production. Industrial relations is not a major problem in Ethiopian small business and job specialization is not strictly adhered to by them, life time employment may not be possible in Ethiopian small business because of limited scope they offer for career growth of employees.

What is more important in the Ethiopian business environment is to change the attitude of work force, make them disciplined and duty conscious, and inculcate in them a sense of commitment towards their organization.

The small business survival rate

As a final note in this section, we must acknowledge the surprising rate of survival by small firms. Debunking many myths about the failure rates if

small firms, recent studies are demonstrating a much higher level of survival for these enterprises than ever envisioned. The most recent statistics show an overall 75.5 percent survival rate over a four-year period. Firms without employees survived at a 72.4 percent rate, and firms with employees experienced at a 90.5 percent survival rate. These are encouraging figures as we begin the new century.
Certainly numerous factors affect this survival rate. One factor enhancing survival may be the technological development experienced over the last few years.

Table 1. Survival rates of small businesses

Firms Surviving	Firms closing each year				
All firms without employees	1992	1993	1994	1995	Until 1996
	7.3	6.7	5.8	4.7	75.5
	8.3	7.7	6.5	5.1	72.4
Firms with employees	2.7	1.5	2.3	3.0	90.5

Source: Haile Gebretinsae Beyene, 2007. Page102

2.7 Forms of business of organization

In the establishment and management of business, the most important thing is to select the proper from out of various forms of business organization. Distribution of profit, concentration of capital, extent of risk, conduct of business control, etc., all depend on the form of business organization. There are different forms of business organization.
The right of an individual or a group of individual to acquire legal title to property for the purpose of controlling them and enjoy the profits and gains from such possession and getting personal satisfaction by operating businesses represents ownership of business.

2.1.8. Sole proprietorship

Meaning and Definition
This is the simplest and oldest for of business organization. It is controlled and owned by a simple person. Under this form of business unit, the individual owner is responsible to introduce the entire capital, uses his/her own skill and intelligence in the management of its affairs, and is entitled to receive all the profits alone, bears the risks that he business faces.

Feature or Characteristics

A. Single ownership: the most important feature of sole trading is that it consists of one person ownership.

B. Individual capital contribution

C. Individual management and control

D. Ownership and risk going side by side

E. No separate existence of business and its owner

F. Limited area of operation

G. Unlimited liability

H. Free from legal formalities in operation

I. Freedom of occupation

Advantages of Sole proprietorship

a. **Easily formed:** it is very easy to form a sole trading enterprise. What is required is simply that the concerned individual should make up his/her mind to start a business. No legal formalities or other complicated formalities are required to be followed. This explains why we find a large number of business units of this form.

b. Incentive: the owner is entitled to the entire profits of the enterprise. He/she is free from any outside intervention. This gives great inventive t her/him to take personal ….

c. Freedom of action: the entrepreneur is the master of his/her business. He/she is free from any outside intervention. He/she can take quick and prompt decisions and implement them.

d. Business secrecy: the owner can keep his/her business secrets entirely to him/herself.

e. Social desirability: from social point of view sole trading enterprises are desirable as they ensure that too much wealth does not concentrate in few hands, because the y are by nature, small undertaking.

f. **Personal Touch:** a sole owner of enterprise is in a position of maintain personal contacts with his/her customers who are limited in number. Individual attention to customers results in creation satisfactory sales. It also enhances good will and reputation of the business. Since the enterprise is small, the owner can create and maintain close tough with his employees. This enables both the employer and the employees to appreciate the difficulties and

problems of each other. This results in to industrial peace which is of vital importance of the prosperity of the business.

g. **Superior output at low cost:** on account of very close supervision over details, quality of the goods is taken care of the cost per unit is low. Nobody can waste materials or time or spoil machines. Here, the overhead charges are also low.

h. **National importance:** there are limits on the expansion of the business of sole limited capital and limited managerial ability of the single entrepreneur. Thus, the growth of business in the form of single proprietorship encourages decentralization and leads to the distribution of income and wealth among many persons. To stimulate entrepreneurs, the state taxes them as individuals and not as a business unit.

i. **Ease of dissolution:** the dissolution of this type of business is as easy as its formation. The decision of the proprietor alone ends the business. He is not required to justify her/his decision to with draw from the business in front of the authorities. He/she s entitled to realize money from business debtors even after the dissolution of the business.

Disadvantages of sole proprietorship

a. **Limited resources:** the entrepreneur, however rich he/she may be, has limited resources. Further, this is also a limit to the amount of loan that one can raise. Thus, the amount of income which derives from such business is relatively small.

b. **Burdon of unlimited liability:** a sole proprietor considers the debts of this business as his personal debts. The fear of not losing his personal property in case of failure of his business makes the sole entrepreneur excessively cautions. This acts as a brake on business expansion.

c. **Limited managerial ability:** one person, however brilliant he/she may be, is not likely to be expert in all matters of business. Thus, the sole entrepreneur's ability to manage his/her business is limited.

d. **Uncertain future:** the sole proprietorship is not at all stable. The business may come to a sudden end with the death, bankruptcy or lunacy/mental illness of the entrepreneur.

2.1.9. Partnership organizations

Meaning and definition

A pane ship is a form of organization in which two or more people jointly owned a business and agree to share the profits or losses in an agreed proportion. Generally, partnership grew out of the single proprietorship.

The partners are joint owners of a business. The partnership is based on the partnership agreement or deed. The number of persons entering in to the agreement, their names, their mutual relations, the amount of capital they are investing, their right and their duties, the share of profit between them, etc, all these are clearly mentioned in the partnership agreement. There are two types of partnership-ordinary and limited. In an ordinary partnership all the partners are responsible for the debts of the firm. Here, the liability of the partners is unlimited. A limited partner's liability restricted (limited) to the amount of capital he/she has invested in the business. But in such partnership there must be at least one general partner whose liability for the debts of the firm not limited in one way. A general partner, however, is the one who has full vice in management and who take complete responsibility for the business. Limited partners cannot take share in management of the firm.

Characteristics of partnership

a. **Plurality of persons**: partnership is an association of persons. It s membership, however, do not exceed more than 20.

b. **Contractual relationship**: this is one of the distinguishing features of partnership from that of other relationships which arise by the operation of law and not from agreement.

c. **Sharing of profit**: an agreement between two or more persons to carry on an activity berth to partnership must be to earn and share profits. Agreement to share profits implies to share losses also.

d. **Existence of business**: profits which are agreed to be shared by the partners must come from a business and not from any other source. This means that there is not business there is not partnership.

e. **Common management**: the business of partnership must be carried on by all or by any one or more of them acting for all. This means that the management of partnership can be entrusted to any one or more than one partner. And even f any one partner is managing the whole business, he/she is deemed to be acting for all. This managing partner is acting as an agent of all other partners and binds them by his/her actions.

f. **Unlimited liability**: each partner has an unlimited liability in respect of the firm's debts. It means that of the assets of the firm are not sufficient to satisfy the claims of the creditors of the firm; the private assets of the partners can also be attached to meet such claims.

g. **Durations**: the partnership business continues to exist until all partners are in a harmony. Legally, partnership comes to an end if any of the partners retires or becomes in solved or dies. However, of the remaining partners agree to continue the business under the original

form name, it may not be dissolved and will continue its activity after settling the claim of the outgoing partner.

Advantages of partnership

A partnership has some obvious advantages over simple proprietorships. This business is small, but not too small. It enjoys all the advantages of small business as well as some advantages of large-scale business. Thus, partnership claims the following merits.

a. **Ease of formation**: like the sole proprietorship, a partnership form can be formed without much expense and legal formalities. All that s required is an agreement among the partners desiring to form a partnership business.

b. **Larger resources**: the resources of the partnership firm are usually larger than those of sole proprietor.

c. **Prompt decision**: it is possible to take decisions quite promptly although not as promptly as in the case of sole proprietorship. But the partners can take balanced decisions as they possess different skills.

d. **Flexibility**: the nature of the business can be changed quickly if the need arises. Only an agreement of the partners is necessary.

e. **Lighter risk**: the losses of the firm are divided and do not have to be borne by one man alone.

Disadvantages of partnership

A partnership suffers from certain from certain drawbacks or demerits also. They are as follows:

a. **Lack of harmony**: misunderstandings generally arise and the business suffers. Quarrels among the partners are quite common. No partner then pays any serious attention to the business.

b. **Unlimited liability**: the partners other than any limited partner are individually responsible for the debts of the business, even to the extent of their private possessions.

c. **Lack of stability**: the partnership firm has to be dissolved in case of retirement, death, insolvency or insanity of a partner. Thus, there is no continuity of life in a partnership.

d. **No legal entity:** a partnership firm has no independent existence apart from the persons who form it.

e. **Limited resources**: the resources at the command of the form will always be less than that of a joint stock company because the partner members are few.

2.1.10. Joint stock company/Corporation

Meaning, organization and finance

When business developed on large scale during the last part of the nineteenth century, even the partnership form of business organization were not sufficient to provide necessary amount of capital which factories, wholesale were houses, and large scale retail stores required. As already pointed out, the main drawbacks of sole proprietorship and partnership were limited resources, unlimited liability and drawbacks of continuity. Thus, in order to overcome these drawbacks, the joint stock company is a business association of people who contribute capital to conduct a business and agree to share the resulting profits or losses. In Ethiopia, Joint stock companies are normally known as Share companies.

A joint stock company is organized initially by interested entrepreneurs known as promoters. These people conceive the scheme of business and they continue to pass through different steps unit the company is formed. They draft the memorandum of association, which contains the name of the company, its location and address, its aims and objectives, the amount of the share capital, the value of shares, etc. on the other hand, the starters of the business draft articles of Association which contains the internal rules and regulations of the company. These rules and regulations include how shares are issued and transferred, how election of the board of directors is conducted, and what are the duties and responsibilities of the directors, etc. The above discussed two important documents of a joint stock company are submitted to the registrar of joint stock companies in the ministry of Industry and commerce for government approval. If the registrar is satisfied that the requirement of the law have been fulfilled, a certificated of incorporation is issued in the name of the joint stock company. The joint stock company then assures its legal body. Thus, a share company can accuse and be accused against any unlawful action that may happen. The money collected, the promoters are supposed to call a general meeting of all the shareholders (share holders). This general meeting of the body of share holders will appoint the board of directors that are responsible to follow the day-to-day affairs of the business enterprise. As we have already seen the owners of sole proprietorship and partnership usually manage their own enterprises. But in a share company every stock-holder is a part-owner, and one joint stock company may have hundreds of shareholders. In addition, every share holder is free to sell some or all his shares at any time. This means that the ownership of the business enterprise may change frequently. In most cases, therefore, it would be impractical for all owners of the joint stock company to participate directly in its management. Instead, they meet once a year to vote on matters of general policy and elect a board of directors to represent them. Each share holder is allowed have votes as he owns shares. For example, if Ato Zeru has 100 shares, he may have only 1o times voting rights. The board directors appoint officials, which is, manager, deputy manager, secrecy, etc…to manage the business enterprise. The manager is then responsible to the board of directors. The board of directors too are, are responsible for reporting annually. It is not

necessary for an officer of a joint stock company to be a shareholder. He can be any salaried entrepreneur.

Chief characteristics of Share Company

a) A share company has a separate legal existence apart from its members. The member and the company are both persons in the eyes if law so that a member of a company can both owns its shares and be its creditor.

b) A share company has a perpetual existence once it is formed it continues for unlimited period of time until it's formal liquidity. The death or insanity of any share holder does not affect it's existence members may come and go but the company would go forever.

c) Unlike a sole proprietorship or partnership the liability of the owner or members of a joint stock company is limited. Of anything goes wrong with the company the share holder can be asked only to the extent of the amount held by him in shares he/she can't be called to meet the debts of the company out of his personal property.

d) Even though shareholders are the owners of share companies, the task of the management is left to the board of directors who are separate from the body of shareholders. A partner is an agent of the partnership firm as well as all the other partners. But a shareholder is not the agent of the company or other shareholders. It is the directors who act as the agent of the company.

e) A partner in a partnership firm cannot transfer his interest without the knowledge of the partners. But the shares of a company are freely transferable except in a special class of companies. The share holders who decide to transfer his/her shares either by selling or by any other means is not forced to tell o make know the other members or shareholders of the company.

f) A partnership can change the purpose of its business activity at any time with the knowledge of the partners. No formality is needed. The purpose for which a company is formed and are given in it's memorandum of association, cannot be changed so easily. This can be changed only with approval of the court.

Private and public limited company

A company can be either private limited or public limited depending upon it's characteristics. The distinguishing feature of private share company will have a limited number of shareholders generally restricted to the members of the family. On the other hand, a public limited company will have a large number of shareholders from different classes of the society. These essential differences between the two relate to their size, method of collecting capital and the transferability of shares. Public companies will be large in size with huge amount of capital where shares will be sold in public

and will be easily transferable also. Unlike this, a private company will have limited capital with fewer shareholders and the shares will be transferred only among themselves and not in open market.

Merits of Joint Stock Company

a. **Financial strength**: the share company form of organization is well convenient for raising large amount of capital. It can issue various type of shares to the public. In the case of public company there is no limit on the number of shareholders. The shares are of small value from a company and leave the responsibility of management to the board of directors. The shareholders are not bothered about management of the business enterprise. They can look after their own business profession or job. Also, as the shares are made transferable by selling them, this works as an add attraction to the investors. All these features help to enlarge the capital of a share company.

b. Limited liability: this is important feature which attract investors to buy shares from company. A shareholder's liability is limited to the value of the shares only. Their personal property cannot be cleared upon for the purpose of liability of the share company.

c. Benefits the Economic of large scale: it is possible to use modern machinery and division of labor by employing specialist workers and large capital so that to benefit higher profits by producing large amount of production at a cheaper price per unit of output.

d. Scope of Expansion: as there is no any limit to the shareholders in a public company, there is a greater scope for expansion of business. A company which is making greater profits can create big reserves which can be used for the expansion of the business.

e. Transferability of shares: a shareholder can sell his/her shares whenever he/she likes. They are not tied up for life to the fortunes of a company. When they need money they can get by selling their shares. Thus this attracts and encourages investors.

f. Social benefits: the share company form of organization has encouraged the habit of saving and investment among the public. Also, as companies employ or hire professionals, managers, it helped the development of management as profession. Further, as the affairs of the company are published and as the companies are regulated and controlled by the state, the public has great confidence in this form of business organization.

Demerits of a share company

A. Formation in difficult: the formation of a share company asks a long process. There are many rules and regulations that must be accomplished before it comes into existence. Also a large amount of money is to be spent in order to fulfill certain preliminaries.

B. **Fraud and Exploitation:** the shareholders can face a chance of exploitation by dishonest directors. This frights away the investors from buying shares from a company.

C. **Centralization of control:** the shareholders who are the proprietors of the company have very narrow chance to participate in the affairs of the business. They are generally spread throughout the country and even in some parts of the world, that is, far away from the business of the share company. Hence, they cannot attend in the company's meetings. The result is that there is a concentration of control in few hands, usually by the directors.

D. **Lack of personal touch:** the larger the organization, the more impersonal it tends to become to both employees and customers that is the owners of the company have not personal touch with the employees and the customers.

E. **Delayed actions:** there are certain things that should be done by the members in their meetings. Their absence any retard the activities of the business. Further, the directors may become irresponsible since their liability is limited.

2.8 Legal issues for the entrepreneur

In establishing a new venture, the entrepreneur should deal with various legal issues. Understanding the legal issues involved in entrepreneurship and taking appropriate measures protect the entrepreneur from later legal complications which might hinder the smooth running of the new business. In this regard, the entrepreneur must seek the assistance of a competent attorney who is a better position to understand all possible circumstances and outcomes related to any legal action.
Some of the legal issues the entrepreneur should address in string a new business are discussed below.
Intellectual property: it refers to excusive right given to the entrepreneur to benefit from his/her innovations and creations; and this includes: patents, trademarks, copy rights, and trade secret. These are very important assets to the entrepreneur and must be understood even before engaging the services attorney. Too often entrepreneurs, because of the lack of understanding of instinctual property, ignore the important steps to take in order to protect these assets.

- **Patents:** a patent is a contract between the government and in inventor. In this contract, the inventor agrees to disclose his/her invention in return for grants by the government exclusively regarding the invention and becomes part of the public domain.

The regulations concerning patent were issued by the transitional government of Ethiopia under the proclamation No. 123 in 1995 GC. The Ethiopian government grants patents for machines, compositions of

matters such as chemical compounds to by use in an industry, manufactured items and for certain types of industrial designs. Previously the Ethiopian science and technology institute was the central government office responsible for the determination of the validity of patents. However, such matter concerning patent right are transferred to the Ethiopian intellectual property office (EIPO).

Importance of patents; having laws and regulations concerning patent and other intellectual properties benefits both the country and the individual entrepreneur in a number of ways:

- It is necessary to create favorable conditions in order to encourage local inventive and related activities there by building up national technological capabilities.
- It has been found essential to encourage the transfer and adaptation of foreign technology; by creating a good environment to assist the national development efforts of the country.
- The task of fulfilling the nation's multidimensional demand for harmonious scientific and technological progress, to be used for the public benefits, shall be most effectively served when there exists an appropriate legal frame work.

Application to get a patent: to obtain a patent in Ethiopian an individual must write an application to EIPO. The application should have three parts.

- **Introduction:** it should contain the back ground and advantages of the invention and the nature of problems that it overcomes. It also should clearly state how the invention differs from existing offerings.
- **Description of the invention:** the application should also should brief description of the drawings that accompany it. Then, this should be followed by a detailed description of the invention, which may include engineering specifications, materials, components, and so on, that are vital to the actual making of the invention.
- **Claims:** claims serve as the criteria by which any infringements will be determined. They serve to specify what the entrepreneur is trying to terms so as to prevent others from getting around the patent. At the same time, the claims must not be so general that hide the invention's uniqueness and advantages.
- **Patentable invention:** to qualify of a patent, an invention must fulfill the following.
  - ✓ An invention is patentable if it is new, involves an inventive step, and is industrially applicable.
  - ✓ An invention shall be considered new if it is anticipated by prior art. Prior art shall consist of everything disclosed to the public, anywhere in the world by publication in tangible form or by oral

disclosure, by use or any other way, prior to the application or, where appropriate. The priority date of the application claiming the invention.

- ✓ Notwithstanding the above provision, the disclosure to the public of the invention shall not be taken in to consideration if it occurred within the 12 months of preceding the filing date or where applicable, the priority date of the application, and if it was by reason or in consequence of acts committed by the applicant or his predecessor in title partly with regard the applicant or his predecessor in title.
- ✓ An invention shall be deemed as involving an inventive step if, having regard to the prior art relevant to the application and defined in the second criterion above, it would not have been obvious to a person having ordinary skill in the art.
- ✓ An invention shall be considered industrially applicable when it can be made or used in handicraft, agriculture, fishery, social services or any other sector.

➢ **Non patentable invention:** as per the patent regulations of Ethiopia the following inventions shall not be granted patent protections:

- Inventions contrary to public order or morality
- Plant or animal varieties or essentially biological processes for the production of plant and animals.
- Schemes, rules, or methods for playing games or performing a commercial activity
- Discoveries of scientific theory and mathematical methods
- Methods for the treatment of the human or animal body by surgery or therapy, as well as diagnostic method practice on human or animal body.

Disputes: occasionally, several people apply for a patent for the same invention. Under the Ethiopian law, the person who first invented the item receives the patent. If it is unclear who invented the item first, the EIPO decides who gets the patent in a proceeding called interference. The losing party can appeal the decision on the court of appeals most other countries grant the patent to who even first applied for the patent protection.

Terms: if the EIPO finds that the invention fulfills the conditions listed above, grants the patent. Under the current Ethiopian law, a patent is given for five years to the individual or individuals who came up with the invention. However, if the inventor is an employee and does not work as of his/her job, the grant will be given to the employer too.

Infringement: it refers to the act of making, using, or selling a patented invention without the consent of the patent holder. Anyone who infringes a patented invention s susceptible to a legal action by the patentee-the holder of the patent. The infringer might argue that the patent should not have been given in the first place and it will be up to the court to decide whether or not the patent is valid. Another defense that can be used by the infringer is the first sell principle. Under is principle, once the patentee sells a particular item, the purchaser of that item may use it or resell it without being considered an infringer.

Options to avoid infringement: to avoid risks that are associated with patent infringement, the entrepreneur should follow the following procedures:

- Assess whether the item is patented or not
- If not patented, file for patent
- If a patent exists, determine whether the patent is new r nearly expired.
- If it is nearly expired, plan for introduction when the patent expires
- If it is new, determine if other expired patents exist the accomplish the same purpose
- If yes, develop the product using other designs
- If no, see if it is possible to introduce some changes in the product and commercialize it without infringement
- If this is not possible, seek a license from the patentee
- If it is possible, produce using the modified version.

Trade Marks: it may be a word, symbol, design, or some combination of such, or it could be a slogan or even a particular sound that identifies the source of the sponsorship of certain goods or services. Unlike the patent, trade mark can last indefinitely, as long as it continues to perform its indicated function. Most countries of the world legally protect trademarks. The current Ethiopian law also gives companies the right to register their trademarks and have them protected. Trade mark registration is carried out by the ministry of Inland revenue; and to be eligible for registration that mark must be used in internal or foreign commerce. Sometimes the public may stop thinking of the trade mark as a brand name and begins to think if it merely as a general category of goods. The trade mark owner fails to do so, he/she will lose his/her legal rights to the trade mark because the use of someone else’s trade mark in a way that confuses the public about the source of the product. And, anyone who does this is considered an infringer and can be sued by the trade mark owner.

Copy right: it refers to the right given to prevent others from printing, copying, or publishing any original work of authorship. The protection in copy right does not protect the idea itself, and thus it allows some else to used the idea or concept in a different manner.

Trade secrets: in certain instances, the entrepreneur may prefer to maintain an idea or process as confidential and sell or license it as a trade

secret. The trade secret will have a life as long as the idea or process remains a secret. The trade secret will have a life as long as the idea or process remains a secret. Employee involved in working with an idea or process may be asked o first sign a confidential information agreement that will protect against their giving out the trade secret either while an employee or after leaving the organization. The entrepreneur should hire an attorney to help draw up any such agreement. The holder of the trade secret has the right to sue any signee who breaches such as agreement. What or how much information to give the employees is difficult to judge and is often determined by eh entrepreneur's judgment.

Review Questions

1. In view of the numerous definitions of small business, how can you decide which definitions is correct?
2. Of the business with which you are acquainted, which is the largest that you consider to be in the small-business category? Does it conform to the size standards use in the book?
3. On the basis of your acquaintance with small-business firms, give an example of a specific small firm I the field of transportation, manufacturing and other public utilities.
4. Define the types of industry on the basis of size, what it makes, market, type, nature of the process of manufacture, and on the basis of the important need of an industry.
5. Of the businesses with which you are acquainted, which of them can be categorized under ancillary industries, tiny sector unit, and rural artisan?
6. Give example to each of the types of small scale industries.
7. By giving examples discuss the characteristics of small scale industries.
8. Suppose you decide to publish a tax advisory newsletter for small-business owners. How would you define your target market in terms of business size? What difference would this decision make?
9. What generalizations can you make about the relative importance of large and small business in Ethiopia?

10. In which sectors of the economy is small business most important? What accounts for its strength in these areas?
11. As noted in this chapter, small business is stronger in some industries than in others. Would it be logical, therefore, for prospective entrepreneurs to concentrate their search for opportunities more in the strong small-business industries-for example, in wholesaling more than manufacturing?
12. What special contribution is made by small business in providing jobs?
13. How can you explain the unique contributions of small business to product innovation?
14. What changes would be necessary for Ford Motor Company to continue operation, if, for some strange reason, all firms with fewer than 500 employees were outlawed? Would the new arrangement be more of less efficient than the present one? Why?
15. In what way does small business serve as a bulk ward of the capitalistic system?
16. List and describe some of the non-financial costs of business failure.
17. Explain and describe some of the quality of management as a cause of failure.
18. What is the difference between saying that “most firms fail within five years”? Which is more nearly correct? Based on the statistics on business failure, would you describe the prospects for new business starts as “bright” or “bleak”? Which is more nearly correct? Based on the statistics failure, would you describe the prospects for new business starts as “bright” or “break”?
19. How can “economic factors,” when cited as a cause of business failure, serve as a mask for other contributing causes?
20. What are the major problems of small business in Ethiopia?

CHAPTER THREE

SETTING A SMALL BUSINESS

Chapter objectives

After completion of this chapter, the student is able to:

- ♣ Identify the various sources of business idea for new venture
- ♣ Understand the methods available for generating new venture/business idea
- ♣ Know the aspects of product planning and development process
- ♣ Understand what project an entrepreneur should have and what factors should be considered in preparing a project
- ♣ Identify the steps in setting small business

Chapter description

This chapter mainly shows how a new business/ venture is established and how business idea is generated and evaluated for further development into real product and service. In a competitive world the secret of success in business is selecting the right product and service, but the problem is how to identify the right product or service. So, how can an entrepreneur identify the best business idea and to select the right product and service are briefly presented in this chapter.

Contents

3.1. Introduction
3.2. Basic business idea
3.3. Source of business ideas
3.4. Methods for generating a good business idea
3.5. What project an entrepreneur should have?
3.6. Steps in business setting

3.1 Basic business idea

All business begins with a business idea. There are many ideas around, but they are not all are business idea. A business idea has two defining characteristics, it meets an **unmet need** and it **drives transaction**.

In the first, the product or service that we offer must satisfy a customer's unmet need. This may mean a brand-new product or service or it may mean finding a way to provide a product or service at a lower price than currently available.
Second a good business idea drive transaction. Whatever the product we offer to customers they must be willing to exchange their money for our product or service. A key point keep in mind is that people do not buy products or services they buy the benefits they get from the product or service. So what benefits are we providing that meet their needs and solve their problem.
The test of a good business atmosphere guides the choice of basic business idea. A basic business idea results from the identification of business opportunities in market.
To be success in business consistently watches 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 business ideas.

3.2 Source of business ideas

Some of the more frequently used sources are:

1) **Market characteristics / observing the market /**
   Careful observation of markets can reveal a business idea. Market can reveal the demand and supply position for various products unfulfilled demand will open the door for new product or service
2) **Government organization:** several government organizations nowadays assist entrepreneurs in discovering and evaluating business ideas. Development bank, state industrial development corporation, technical consultancy organization, etc. provide assistance in technical, financial, marketing and other areas business. Government rule, regulation and policy on import and export, research and training service etc encourage entrepreneurs to think about the new option.
3) **Development in other nation:** people in under developed countries generally follow the fashion trend of developed countries. Therefore an entrepreneur can discover good business idea by keeping in touch with development in advanced nations. Sometimes, entrepreneurs visit foreign countries in search of ideas for new product or service.
4) **Social and economic trends**
   Social and economic status of people is always dynamic in nature and offer wide opportunities. An entrepreneur should observe such change.
5) **Emerging new technology**.
   Commercial exploitation of indigenous or imported technologies and know how is another source of project idea.
6) **Trade fairs and exhibitions:** national and international trade fairs are very good sources of business idea. At these fairs, producers and

dealers in the concerned industry put up their products for display and / for sale.

Magazines, journals, industries, trade fairs offer wide scope for business opportunities

Activity: Discuss sources of business ideas in your locality

3.3 Methods for generating business idea

The entrepreneur can use several methods including focus groups, brainstorming, and problem inventory analysis to come up with and test new ideas.

A. Conducting research: an entrepreneur can primarily generate new business idea by conducting a target research. It is necessary to estimate future demand and take in to account anticipated change in fashion income levels, technology, etc.

B. Focus groups: is a group of individuals providing information in a structured format, a moderator, often called a focal person leads a group of people through an open in depth discussion rather than simply asking questions to solicit/seek participants' response. For a new product area, the moderator focuses the discussion of the group in either a directive or a non-directive manner. The group of participants is stimulated by comments from other group members in creativity conceptualizing and developing a new product idea.

C. Brainstorming: is a group method of obtaining new idea and solution. Brainstorming is probably the most well known and widely used techniques for both creative problem solving and idea generation. It is an unstructured process for generating all possible ideas about a problem within a limited frame though the spontaneous contributions of participants. It serves to generate as many ideas as possible to screen out for further development. A good brainstorming session starts with a problem statement that is neither too broad nor too narrow.

Once the problem statement is prepared, a group of individuals is to forward a wide range of knowledge. The following rules should be followed while using this method.

- ❖ No criticism is allowed by anyone in the group –no negative comments.
- ❖ Freewheeling is encouraged –the wider the idea the better.
- ❖ Quality of ideas is desired- the greater the number of ideas, the greater the likelihood of useful ideas emerging.
- ❖ Combinations and improvements of ideas are encouraged- ideas of others can be used to produce –still another new idea.
- ❖ The brainstorming session is fun, not to be spoiled with seriousness.

D. Problem inventory Analysis: is a method for obtaining new ideas and solution by focusing on problem. Problem inventory analysis uses individuals a manner analogous to focus groups to generate new product ideas. However, instead of generating new ideas themselves, consumers are provided a laundry list of problems in a general product category. They are then asked to identify and discuss products in this category that have particular problem. This method is often effective since it is easier to relate, known products to suggested problems and arrive at a new product idea than to generate an entirely new product idea by itself. Problem inventory analysis can also be used to test a new product idea.

3.4 Product planning and development process

A firm can obtain new products in two ways. One is through acquisition by buying a whole company, a patent, or a license to produce: someone else's product. The other is through new product development by the company's own research and development (R&D) efforts. By new products, we mean original products, product improvement, products modifications or new brands that the firm develops through its own R&D endeavors. The product planning and development process comprises several major steps.

Step 1: Idea generation: new product development starts with idea generation –the systematic search for new product ideas. The ideas could emerge from idea sources or creative problem solving. However, they need an in-depth development and refinement in to the final product or service to be offered. A company ought to generate as many ideas as possible in order to find a few good ones.

Step 2: Idea screening: once the ideas are emerged from idea source, they need further development, screening and evaluation. Business ideas/opportunities need to be screened and assessed for viability once they have been identified or generated. The purpose of the succeeding stages is to reduce that number. The first idea reducing stage is idea screening, which helps spot good ideas and drop poor ones as soon as possible.

Process of screening ideas

Step 1: list down all the business ideas you identified.

Step 2: down screening the ideas into small number of business ideas (micron screening).

Usually it is not possible for an entrepreneur to pursue all of its opportunities, so it must try too much the opportunities to its resources and objective based on screening criteria. Some of the common criteria for screening ideas are:

- Profitability of the idea if implemented
- Availability of raw materials and resources
- Personal goals and competence of the entrepreneur
- Financial requirements
- Risk exposure criteria
- Government priority and support

- Marketability /demand: the greatest mistake people make when starting a new business is that they try to sell products they like. However, it is better first to understand what people want to buy not want you want to sell. You have to listen, what the marketplace needs, and you should anticipate the future demand of the product.
- Ease of implementation: the generated idea can be evaluated based on whether the idea is converted into real business easily. The entrepreneur should consider the points
-
- **Step 3:** finer cross checking of the key variables affecting the success or the failure of the business
- **Step 4:** selecting the best business idea

Step 3: concept development and testing: an attractive idea must be developed into a product concept. It is important to distinguish between a product idea, a product concept and a product image. A product idea is an idea for a possible product that the company can see itself offering to the market. A product concept is a detailed version of the idea stated in meaning full customer terns. Moreover, a product image is the way customers perceive an actual or potential product.

- Concept testing calls for testing new product concepts with group of target customers. The concepts may be presents to consumers symbolically or physically. For some concept tests, award or picture description might be sufficient. However, a more concrete and physical presentation of the concept will increase the reliability of the concept test.

Step 4: marketing strategy development: after concept testing proves best, the next step is marketing strategy development, designing an initial marketing strategy for introducing the proposed product to the market. The marketing strategy statement consists of three parts:

- The **first part** describes the target market; the planned product positioning, sales, market share and profit goals for the first few years.
- The **second part** of the marketing strategy statement outlines the product's planned price, distribution and marketing budget for the first few years.
- The **third part** of the marketing strategy statement describes the planned long run sales, profit goals and marketing mix strategy.
- **Step 5: business analysis:** once management has decided on its product and marketing strategy, it can evaluate the business attractiveness of the proposal. Business is a basic assessment of products compatibility in the market place and its potential profitability. The size of the market, competing products and market demand (questions like how will the product affect the firm's sales, costs and profits) are often studied at this point.

Step 6: product development: if the product survives the first five steps, it is developed into a prototype that should reveal its intangible attributes as perceived by the consumer. Product development is often expensive, and

few product ideas make it to this stage. Here, R&D or engineering develops the product concept into a physical product. Developing a successful prototype can take days, weeks, months, or even years. Often, products undergo rigorous tests to make sure that they perform safely and effectively, or that customers will find value in them. During product development, various elements of marketing mix must be developed for testing. Copyrights, promotion strategy, packaging, labeling and description of a target market are integrated to develop an overall marketing strategy.
Step 7: test marketing: test marketing is a trial mini-launch of a product in limited areas that represent the potential market. it allows a complete test of marketing strategy in a natural environment, giving the organization an opportunity to discover weaknesses to be eliminated before the product is fully launched. Testing new products can be expensive, but it's necessary to avoid product disasters.
Step 8: Commercialization: Commercialization is the full introduction of a complete marketing strategy and the launch of the product for commercial success. During commercialization, the firm gears up for full-scale production, distribution and promotion.

3.5. What project an entrepreneur should have?

A project can be defined in different ways. A **project** is a complex of economic activity in which the players commit scarce resources in the expectation that the benefits gained will exceed these resources.
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.

a. **Opportunity ;**refers to any factor that offer promise or potential for moving closer or more quickly towards the firms goal
b. **Threat;** is any factor that may limit or impede the business in the pursuit of its goals
c. **Strength;** is an inherent capacity, which an organization can use to gain strategic advantage over its competitors.
d. **Weakness;** is an inherent limitation or constraint, which creates a strategic disadvantage.

To be a successful an entrepreneur, one major determinant factor is the choice of a good business idea. To select the best business idea, the following steps needs to be pursued.
A. Identifying your problem
B. Define your objectives
C. Identifying ,develop and analyze the possible alternative

D. Select the best alternative in light of the specific criteria set to the better fulfillment of the objective.

3.6 Steps in business setting

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

These must be examined with a view to assess;

A. The marketing aspects
B. Technical aspects
C. Financial aspects

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

a. A detailed estimate of demand is to be made.
b. Technical specifications of the process should be carefully studied.
c. The equipment required and their sources are to be specified
d. Requirement of space
e. The total cost of the project to be worked out the means for financing it identified
f. The economics of the entire scheme at projected operating level is to be assessed.

3) Implementation of detailed project report Includes;

- deciding on form of ownership and registration
- obtaining finance
- obtaining license
- establishing necessary infrastructure

4) Once all the required authorizations and sanctions have obtained, simultaneously action is to be taken for the following.

♣ Pre –commissioning requirement

A. Ordering machinery from suppliers
B. Obtaining utilities, like power and water connections after constructions of shed, if necessary.

C. recruitment of staff
D. arranging supplies of materials
E. arranging for distribution of the products

5) Once these are complete, the plant is ready for commissioning trial run may be made.

♣ Commissioning of plant

Includes;

- Trial run of machineries
- Promotional activity for the product
- Introduce the product to the market and obtain feedback

6. The unit is then ready for commercial production.

♣ Commercial production

Summary

The starting point for any successful new venture is the basic product /service to be offered. This idea can be can be generated internally or externally through various techniques.

The possible source of new idea ranges from the comment of consumer to changes in government regulation. Monitoring comments acquaintances, evaluating the new products offered by competitors. Becoming familiar with the ideas contained in previously granted patents, and becoming actively involved in research and development are techniques for coming up with a good product idea. In addition, there are specific techniques entrepreneur can use to generate ideas. For example understanding of the consumer's true opinion can be gained from using a focus group. Another consumer oriented approach is problem inventory analysis through which consumers associate a particular problem with specific products and then develop a new product that does not contain the identified faults.

Once the idea or group of idea is generated, the planning and development begins. if a large number of potential ideas have been uncovered, they must be screened and evaluated to determine their appropriateness for further development. Ideas showing the most potential are then moved through the concept stage and finally into commercialization. The entrepreneur should constantly evaluate the idea through this process in order to be able to successfully launch the venture.

Review questions

Choose the best answer from the given alternatives

1. Which one is/are not true about brain storming methods of idea generation?
   A. It is well known method for both idea generation and creative problem solving
   B. It is a structured
   C. It serves to generate as many ideas as possible to screen out for further development
   D. All
2. The business idea need to be screened ,assessed for viability once they have been identified or generated in stage---
   A. Idea generation
   B. Idea screening
   C. Market strategy
   D. Business analysis
3. _____ is a trial min launch of a product in limited areas that represent the potential market.
   A. Product concept testing
   B. Test marketing
   C. Commercialization
   D. Business analysis

4. Which one of the following element should included in project report when in setting a manufacturing firm
   A. The total cost of the project and its means of financing
   B. The required equipment and its source
   C. Technical specification of the product
   D. Space requirement
   E. All
   F. All except

Discussion questions

1. Discuss the product planning and development process?
2. Discuss what factors consider when an entrepreneur prepared a project?
3. Write the difference that lies between brain storming and focus group?

CHAPTER FOUR

THE BUSINESS PLAN

Chapter objectives

Dear distance learners, after thorough reading of this chapter, you will be able to:

- ♣ Define what the business plan is, who prepares and uses it, and how it is evaluated.
- ♣ Identify information needs and sources for business plan.
- ♣ Understand how to monitor the business plan.
- ♣ Understand the elements should be included in the business plan.

Chapter description

What a business plan is, the importance of a good business plan, the formats of business plan, the purpose of business plan, the users of business plan, the time for the preparation of business plan, the reason for failure factors and the main components of a business plan are presented in this chapter.

Contents

4.1. Why is planning is so important?
4.2. What is Business Plan?
4.3. Benefits of a Business Plan
4.4. The purpose of business plan
4.5. Users of business plan
4.6. When the business plans are produced?
4.7. Why some business plan fails
4.8. Components of business plan (outline of a business plan)

IV.1 Why is planning is so important?

"Business don't plan to fail, they just fail to plan"

Before we go into the nitty-gritty part of business plan, it is important that every individual understand the importance of planning for the success of any venture. As the matter of fact, in Ethiopia most of us are not used to the planning process. Planning which is the process of setting objectives and devising actions to achieve those objectives, answers such as what business I have? What is my sales strategy? Where I can found the needed personnel? How much profit can I expect?

Planning is the process never ends for a business. It is extremely important in the early stage of any new venture when the entrepreneur will need to prepare a preliminary business plan. The plan will be finalized as the entrepreneur has a better sense of the market, the product or service to be marketed, the management team, and the financial needs of the venture. For any given organization, it is possible to find financial plan, marketing plan, and human resource plan, production plan, and sale plan, etc.

IV.2 What is Business Plan?

A business plan is the written document that details the proposed venture. It must describe current status, expected needs, and projected results of the new business. Every aspect of the venture needs to be covered: the project, marketing, research and development, manufacturing, management, critical risks, financing, and milestones or a timetable. A description of all of these facets of the proposed venture is necessary to demonstrate a clear picture of what that venture is, where it is projected to go, and how the entrepreneur proposes it will get there. The business plan is the entrepreneur's roadmap for a successful enterprise. Whatever the name, it should lay out your idea, describe where you are, point out where you want to go, and how you propose to go there. The business plan may present a proposal for launching an entirely new business.

More commonly, perhaps; present a plan for a major explanation of a firm that has already started operation.

IV.3 Benefits of a Business Plan

Specifically for the entrepreneur:

- The time, effort, research, and discipline needed to put together a formal business plan force the entrepreneur to view the venture critically and objectively.
- The competitive, economic, and financial analysis included in the business plan subject the entrepreneur to close scrutiny of his or her assumptions about the venture's success.
- Since all aspects of the business venture must be addressed in the plan, the entrepreneur develops and examines operating strategies and expected results for outside evaluators.
- The business plan quantifies objectives, providing measurable benchmarks for comparing forecasts with actual results.
- The completed business plan provides the entrepreneur with a communication tool for outside financial sources as well as an operational tool for guiding the venture towards success.
- Details of the market potential and plans for securing a share of that market.
- The venture's ability to service debt or provide an adequate return on equity.
- Identifies critical risks and crucial events with a discussion of contingency plans.
- A clear, concise document that contains the necessary information for a thorough business and financial evaluation.

IV.4 The purpose of business plan

The most important steps in establishing any new business is the constructions of a business plan. Business plan:

1. It can help the owner/manager crystallization and focus his/her idea.
2. Although planning is a mental process, it must go beyond the realm thought. Thinking about a proposed business become more rigorous as rough ideas must be crystallized and qualified on paper.
3. It can help the owner/manager set objectives and give him a yardstick against which to monitor performance.
4. It can also as a vehicle to attack any external finance needed by the business.

5. It can convince investors that the owner has identified high growth opportunities.
6. It entails taking a long _term view of the business and its environment.
7. It emphasizes the strengths and recognizes the weaknesses of the proposed venture.
8. The plan can uncover weakness or alter the entrepreneur to sources of possible danger.

IV.5 Users of business plan

A business plan has two primary functions:

- ♣ To provide clearly articulated statement of goals and strategies for internal use and,
- ♣ To serve a selling document to be shared to the outsiders.

Those who might have an interest in a business plan for a new venture consists of **outsiders** who are critical to the firm's success: customers, suppliers, and investors. The other group is the **internal** users of the business plan: the new firm's management. Let us consider the internal users first.

I. Internal user of the business plan

Any activity without adequate preparation tends to be disorganized. This is particularly true of such a complex process as initiating a new business. Although planning is a mental process, it must go beyond the realm of speculation. Internal users are, firms management and employees of the venture.

II. External users of the business plan

By enhancing a firm's credibility, the business plan can serve as an effective selling tool to use with prospective customers and suppliers, as well as investors. Suppliers for example, extend credit, which is often an important part of a new firm's financial plan. A well prepared business plan may be helpful in gaining a supplier trust and securing favorable credit terms. Both investors and lenders use the business plan to better understand the new venture, the type of product/service it offers, the nature of the market, and the qualification of the entrepreneur and the management team.

IV.6 When the business plans are produced?

1. **At the start up of a new business :**
   After the concept stage of initial ideas and feasibility study, a new business start up many go through a more detailed planning stage of which the main output is the business plan.
2. **Business purchase**:

Buying an existing business does not neglect the need for an initial business plan. A detailed plan, which tests the sensitivity of changes to key business variables, greatly increases the prospective purchasers understanding of the level of risk they will be accepting, and likelihood of rewards being available.

3. **Ongoing:**
   Ongoing review of progress, against the objectives of either a start up or small business purchase, is important in a dynamic environment. An initial business plan is not a document to be put in a drawer and forgotten.
4. **Major decisions**:
   Even if planning is not carried out on a regular basis, it is usually investigated at a time of major change. For example, the need for major new investment in equipments, or funds to open a new outlet, It may be linked to failure, such as a recovery plan for an ailing (or in bad condition) business.

IV.7 Who produced the business plan?

Three types of people will be interested in a business plan:

1. **Managers:** are involved in small business planning as both producers and recipients of the plan. Business plans are written to aid small business managers.
2. **Owners:** the manager of a small enterprise may also be the owners and take a keen (eager) interest in the planning process, wearing their shareholders hat.
3. **Lenders:** the major banks/lenders all encourage the production of business plans to justify overdrafts and loans, offering literature and advice on putting together business plans.

IV.8 Why the business plans are produced?

1. Assessing the feasibility and viable of the business plan/project: it is in every ones interests to make mistakes on paper, hypothetically testing for feasibility, before trying the real thing.
2. Setting objectives and budgets: having a clear financial vision will believable budgets is a basic requirement of everyone involved in a plan.
3. Calculating how much money is needed: a detailed cash flow with assumptions is vital ingredient to precisely quantify earlier the likely funds required.

IV.9 The format of a business plan

The business plan needs to answer three –straight forward questions:

1. Where are we now?

An **analysis of the current situations** of the market place, the competitions, the business concept and the people involved. It will include any historical background relevant to the position to date.

2. **Where do we intend going?**
   Qualitative expression of the objectives, quantifiable targets will clarify and measure progress towards the intended goals.

3. **How much we get there?**
   Implementing of accepted aims is what all the parties to a plan are interested in as a final result.Plans for marketing and managing the business, with detailed financial analysis are the advisable preliminaries before putting it all in to practice.

Writing the business plan

The business plan could take much time to prepare, depending on the experience and knowledge of the entrepreneur as well as the purpose it is intended to serve. It should be a comprehensive enough to give any potential investor a complete understanding of the new venture. The outline for a business plan is illustrated in figure 5.2.

Introductory page

This is the title or cover page that provides a brief summary of the business plan's contents. The introductory page contains the following:

- ❖ The name and address of the company
- ❖ The name of entrepreneur(s) and telephone number
- ❖ A paragraph describing the company nature of the venture
- ❖ The amount of financing needed. The entrepreneur may offer a package that is
  stock, debt and so on.
- ❖ A statement of the confidentiality of the report. This is for security purpose and it is important for the entrepreneur.

This title page sets out the basic concept that the entrepreneur is attempting to develop. Investors consider it important because they can determine the amount of investment needed without having to read to the whole through the entire plan.

Executive summary

This section of the business plan is prepared after the total plan is written. About three to four pages in length, the executive summary should stimulate the interest of the potential investor. The investor uses the summary to determine if the business plan is worthy reading in total. Thus,

it would highlight concisely and convincingly the key points in the business plan, that, is the nature of the venture, financing needed, market potential, and support as to why it will succeed.

Industrial analysis

It is important to put the new venture in a proper context. In particular the potential investors, while assessing the venture on a number of criteria, it needs to do an industry analysis in order to know which industry an entrepreneur will be competing on it. The entrepreneur should also provide insight on new product development in this industry. Competitive analysis is also an important part of this section. Each major competitor should be identified, with appropriate strengths and weakness described particularly as to how they might affect the new venture's success in the market.
Who is the customer? The market should be segmented and the target market of the entrepreneur identified. Most new ventures are likely to compete effectively in only one or few of the market segments.

Description of the venture

The description of the venture should be detailed in this section of the business plan. This will enable the investor to ascertain the size and scope of the business. Key elements are the product(s) or services(s), the location and size of the business, the personnel and office equipment that will be needed, the background of the entrepreneur(s) and the history of the venture. Location of any business may be vital to its success particularly if the business is retail or involves a service. Thus, the emphasis on the location in the business plan is a function of the type of business. In assessing the building or spaces the business will occupy, the entrepreneur needs to evaluate such factors as parking, delivery rates, access to customers, suppliers and distributer, and accommodating own regulation or zoning laws.
This simple assessment of the location, market and so on saved the entrepreneur from a potential disaster.

Production plan

If a new venture is a manufacturing operation, a production plan is necessary. This plan should describe the complete manufacturing process. If some or all of the manufacturing process is subcontracted, the plan should describe the subcontractors(s), including location, reasons for selection, costs, and any contracts that have been completed. If the manufacturing is to be carried out the whole or in part by the entrepreneur(s), s\he will need to describe the physical plant nay out; the machinery and equipment needed to perform the manufacturing operation raw materials and suppliers' names, address, and terms, cost of manufacturing and any further capital requirement.
If the venture is not a manufacturing operation but a retail store or service, this section would be titled ‘’**merchandising plan’’** and purchase of

merchandise, inventory control system, and storage needs should be described.

Marketing plan

The marketing plan is an important part of the business plan since it describes how the product(s) or service(s) will be priced, promoted and distributed. Specific forecasts for products are indicated in order to project profitability of the venture. The budget and appropriate controls needed for marketing strategy decision should be discussed.

Potential investors regard the market plan as critical to the success of the new venture .thus the entrepreneur should make any effort to prepare as a comprehensive and detailed plan as possible so that investors can be clear as to the goals and strategies of the venture. Marketing planning will be an annual requirement (with careful monitoring and changes made on weekly or monthly basis) for the entrepreneur and should be regarded as the road map for short term decision making.

Organizational plan

The organizational plan describes the venture's form of ownership –that is, proprietorship, partnership, or corporation. For instance, if the venture is the partnership, the term of the partnership should be included. If the venture is a corporation, it is important to detail the share of the stock authorized, share options, names and address and resumes of the directors and officers of the corporation.

Assessment of risk

Every new venture will be faced with some potential hazards, given the particular industry and competitive environment. It is important that the entrepreneur makes an assessment of risk and prepares an effective strategy to deal to them.

Major risk for a new venture could result from a competitor's reaction; weakness in the marketing or production, and new advances in technology that might render the new product obsolete. It also important for the entrepreneur to provide alternative strategies should any of the above risk factors occur.

Financial risk

The financial plan, like the marketing, production, organization plans, is an important part of business plan. It determines the potential investment commitment needed for the new venture and indicates whether the business plan is feasible.

Generally, three financial areas discussed in this section of the business plan. **First**, the entrepreneur should summarize the forecasted sales and the appropriate expense at least the first five years. It includes the forecasted sales, cost of good sales, and the general and administrative expenses.

Second, cash flow figure must be presented for at least the first three years, with the first year's projection provided with monthly. **The last**

financial item needed in this section of the business plan is the projected balance sheet. This shows the financial condition of the business at specific time. It summarizes the asset of a business, its liabilities, the investment of the entrepreneur and any partners, and retained earnings or cumulative losses.

Appendix

The appendix of the business plan generally contains any back up material that is not necessary in the text of the document. Reference of to any of the document in the appendix should be made in the plan itself.

Using and implementing the business plan

The business plan is designed to guide the entrepreneur through the first three year of operation. It is important that the implementation of the strategy contain control points to ascertain progress and to initiate contingency plans, if necessary.

Many business fail because of the entrepreneur inability to plan effectively. Intelligent planning is not difficult or impossible exercise for the inexperienced entrepreneur. With the proper commitment and support from any outside resource, the entrepreneur can prepare an effective business plan.

IV.10 Why some business plan fails

Generally a poor prepared business plan can be blamed on one or more of the following factors:

- ❖ Goals set by the entrepreneur are unreasonable
- ❖ Goals are not measurable
- ❖ The entrepreneur has not made a total commitment to the business.
- ❖ The entrepreneur does not have experience in the planned business.

Components of business plan (outline of a business plan)

I. Introductory page

A. Name and address of the business

B. Name(s) and address(s) of principals

C. Nature of business

D. Statement of financing needed

E. Statement of confidentiality of report

II. Executive summary

III. ***Industry analysis***

A. *Future outlook and trends*
B. *Analysis of competitors*
C. *Market segmentation*
D. *Industry forecast*

IV. ***Description of venture***
A. *Product(s)*
B. *Service(S)*
C. *Size of business*
D. *Office equipments and personnel*
E. *Background of entrepreneur*

V. ***Production plan***
A. *Manufacturing process (amounts sub contracted)*
B. *Physical plant*
C. *Machinery and equipments*
D. *Names of supplier of raw material*

VI. ***Marketing plan***
A. Pricing
B. Distribution
C. Promotion
D. Production forecast
E. Controls

VII. Organizational plan
A. Form of owner ship
B. Identification of partners and principal share holders
C. Authority of partners
D. Management team background
E. Roles and responsibility of members of organization

VIII. ***Assessment of risks***
A. *Evaluation of weakness of business*
B. New technologies
C. Contingencies plan

IX. ***Financial plan***
A. *Pro forma income statement*
B. *Cash flow projections*
C. *Pro forma balance sheet*
D. *Break even analysis*
E. *Source and application of funds*

X. ***Appendix***
A. *letters*
B. *market research data*
C. *leases and contracts*
D. *price lists from suppliers*

Assignment

Assume that you want to start a business to produce something or provide service; prepare a business plan for your business in the near future, be noted that you should follow the outline of preparing the plan and not more than 12 pages type written business plan. (Maximum score is 30%).

Summary

This chapter has established the scope and value of business plan and outlined the steps in its preparation. The business plan may be read by employees, investors, customers, supplier, and consultants. The scope of the plan deepened on who reads it, the size of venture, and the specific industry for which the venture is intended.

The business plan is essential in launching a new venture. The results of many hours of preparation will represent a comprehensive, well written, and well organized document that will serve as a guide and an instrument to the entrepreneur raise the necessary capital.

Before beginning to write the business plan, the entrepreneur will need information on the market, manufacturing operations, and financial estimations. This information should be evaluated based on the goals and objectives of the new venture. These goals and objectives also provided a frame work for setting up controls for the business plan.

IV.11 SAMPLE OF BUSINESS PLAN

Sample Business Plan
Gambo Ostrich Farm

---

1. Introduction

1.1 Company name

The company shall be named Gambo ostrich farm P.L.C

1.2 The name and addresses of partners

1. Alemu ketema W.00 keble 00 House No 00
2. Yesuf Ahemed W.00 keble 00 House No 00
3. Kebed alemu W.00 keble 00 House No 00

1.3 Nature of business

The business involves ostrich farming. The company shall produce high quality ostrich, feathers and meat for export purpose…….

1.4 Statement of financial statement

The company shall be established with a capital of Birr 1, 000, 0000,000 which will be raised from the partners and the bank loan. The owner's contribution shall be……. The money is required to acquire land and equipments, to build facilities …….

1.5 Confidentiality of the report

This document is confidential and proprietor. It may not be circulated or disclosed in whole or part without the written permission of the partners. Plans and projections are subject to change.

2. Executive summary

Gambo ostrich farm shall be established as a private limited company in Bulbula town, oromia with Alison office in Addis Abeba .the capital required to start the business shall be acquired through bank loan and partners contribution.

The company shall produce high quality …….

Gambo ostrich farm shall have a capital of birr 1, 000, 000, 0000 ……. The company shall mark its products available for the market as…….

3. Industry analysis

3.1 Futures outlook and trends

The introduction of ostrich hides as a luxury leathers has increased interest in ostrich farming in the last few decades…….

3.2 **Analyses of competitors**’

Currently there are no competitors’ in the local market. However, the company shall have many international competitors’, as it products are sold in the international market. These competitors come from…….

Strength of competitors

The major strength of our competitors are high quality products, strong business network, and …….

Weakness of competitors

The weakness of our competitors is high production and transportation coasts which normally result in higher price. And also …….

3.3 Market Segmentation

The market for the company’s products is divided into four major regions as follows;

1. Europe
2. U.S.A
3. Middle east
4. Asian market

4. Description of the venture

4.1 Products

The primary products of the company shall be

1. ostrich hide
2. ostrich feather

3. ostrich meat

4.2 Size of the business

The business shall be of medium size initially. However, the company shall be expand as it requires more market share internationally. In the near future …….

4.3 Office equipments and personnel

The company shall require some office equipment and personnel.
Office and related equipment requirement

No	Description	Qty	Unit price (Birr)	Total price(Birr)
1	Gust chair	6	200	1,200
2	Filling cabinet	2	1,000	2,000
3	Personal computer	3	8,2000	24,600
4	….	…….	…….	……
	…	Total		

Man power requirement

No	Description	Qty	Monthly pay	Annual pay
1	General manager	1	1,500	18,000
2	Secretary	1	500	6,000
3	Accountant	1	750	9,000
4			…….	…….
	total			…….

4.4 Background of the entrepreneur

The partners have rich experience in poultry farming which will significantly contribute to the successful establishment and operation of the ostrich farm.

4.5 Location of the business

The ostrich farm, where the ostrich breeding and processing shall take place, shall be located in eastern shoa, Bulbula town, 200 km away from Addis Ababa**.**

5. Production

5.1 Production process

Ostrich hide

The ostrich shall be sloughed and…….

Ostrich feather

The feather collected from the ostriches shall go through the process of ……

5.2 Physical plant

The ostrich farm shall consist of the following facilities

1. ostrich shelter
2. slaughtering room

5.3 Equipment and machinery

The following machinery shall be required

1. slaughtering machinery
2. refrigerator
3. hide processing machine

6. Marketing plan

6.1 Pricing

The company shall use market penetration strategy to introduce its products and to easily establish it's in the international market. The tentative prices of the company's products is presented in the table below…….

6.2 Promotion strategy

It is imperative that the company be advertised to attract the attention of customers in the target market. Accordingly the company's products shall be advertised through ……

7. Financial plan

7.1 **F**orecasted income statement for the next five years

	Y1	Y2	Y3	Y4	Y5
Revenue					
Sales		4,549,200	6,823,000	9,098,000	11,373,000
Expenses					

Office.exp		5,000	5,000	8,000	8,000
w/shop exp.	5,000	15,000	15,000	18,000	18,000
Custom exp.	13,000	30,000	35,000	40,000	45,000
Transport exp.	20,000	400,000	450,000	500,000	550,000
Rent exp.	124,000	124,000	124,000	124,000	124,000
…..	……	…….	……		….
Income tax/35%	(…..)	(……..)	(……..)	(……)	(……..)
Net income	(……)	(…….)	(…….0	(…..)	(….)

7.2 Forecasted balance sheet for the next five year

Gambo ostrich farm P.L.C

Forecasted balance sheet

End of years 1-5

No	**Assets**	Y1	Y2	Y3	Y4	Y5
1	CASH	635,150	679,220	750,290	765,360	811,430
	Vehicle	240,000	180,000	120,000	60,000	0
	……..	……	……..	…..	……..	….
	Total asset	……	……..	…….	…….	….
No	**Liability**					
1	Bank loan	400,000	350,000	200,0000	100,000	

	Total liability	…..	….	……	…..	….
2	**Owner's equity**					
	A. Alemu	300,000	…….	…….	…….	…..
	B. Yesuf	100,000	……..	……..	…….	….
	C. Kebed					
	Total capital	…….	……..	…..	…..	….

7.3 forecasted cash flow statements for the next five years

Gambo ostrich farm P.L.C

Forecasted cash flow statement

For the years 1-5

	Y1	Y2	Y3	Y4	Y5
Cash flow operating activities	…….	……	……..	……	…..
……	…….	……	……	……	….
Ending					

8. Organizational plan

8.1 Organizational structures

General manger

8.2 Forms of ownership

Gambo ostrich farm shall be established as a private limited company (P.L.C)

8.3 management team

1. Alemu ketema
2. Yesuf ahemed
3. …….
4. ……

9. Assessment of risk

8.1 Weakness of the business

Since ostrich farming is a new business for Ethiopia, their will be a shortage of……

8.2 Effects of change

Competition

Given the increasing number of ostrich farms that join the market, it is expected that prices are gradually decreases. However…….

8.3 Contingency plan

Should the demand for the company's products decreases, which does not require much additional investment in……

(Adapted from: "business plan of Gambo ostrich farming "Dawit Arega,et al)

Discussion questions

1. Why is a business plan so important to the entrepreneur? To the investor? To the customer? To supplier?
2. What kind of information should be provided in the industry analysis of the business plan? Where can the entrepreneur get information on any specific industry?
3. Why do some business plan fails?
4. What is the purpose of the financial plan to the potential investor?
5. What elements should be included in the business plan? And the points covered in each element?

CHAPTER FIVE

MARKETING IN SMALL BUSINESS ENTERPRISES

Chapter objectives:

At the end of this chapter, students will be able to;

- ♣ Understand the role of marketing in small business
- ♣ Describe the marketing mix elements
- ♣ Understand different methods available to collect market research
- ♣ Discuss various market segmentation options
- ♣ Discuss different marketing strategies for small business enterprises

Chapter description

Since marketing is a core concept in making a business profitable, this chapter deals with the main marketing strategies that make small firms more profitable and it will also help them to expand their business. Marketing research which is the back bone to understand both the current and future market opportunity is also presented briefly.

Contents

5.1. The Marketing Perspective
5.2. The Marketing Mix
5.3. Market Segmentation
5.4. Market research
5.5. Methods of collecting market information
5.6. Marketing Strategies for the small firm

5.1 *The Marketing Perspective*

It is all well and good having a product or service idea, but will it prove to be a profitable business?
Too many businesses are set up without thinking about this essential question. The answer revolves around the most important person in any business. The customer marketing is the process of matching the needs of the consumer to the capabilities and resources of the firm.

Marketing is about making money from satisfied customers; without satisfied customers there can be no more future for any commercial organization, though, marketing is an attitude of mind about satisfying the customer rather than a set of sales techniques, and to understand the customer you need to take what is called a marketing perspective. The customer is the buyer of the product or service. This person may not be clam person as the consumer, or user of the product or service. Understanding customer and consumer needs and motivations in central to marketing for small firms.

In marketing terms customers buy benefits. They do not buy features or characteristics of a product or service. We do not buy oil for our cars because we like it, but because it makes the engine run smoothly, extends the engine’s life and reduces our repair bills. What is more, the benefits that

customer's value may be different to those valued by the consumers of a product or service. Understanding the differences between the features of a product or service and the benefits that it offers the customer is the cornerstone of marketing. The customer is really only interested in benefits. The features simply prove to the customer that he will receive those benefits. However, that customer is actually buying a whole package of benefits that the product or service has to offer. That package can include things like after sales service, image, reliability, ease of use, easy of availability, e.t.c.

It is the value to the customer of the total package that the firm is seeking to maximize in marketing. The higher the total value to the customer, the greater their loyalty to the product or service and the higher the price they are likely to pay for it.

5.2 *The Marketing Mix*

Each element of the marketing mix is unique for every business. Indeed the development of such a unique mix is the aim of the marketing strategy of the business. Marketing mix consists of product, price, promotion and place (distribution) or 4P'S.

i) Product (Service)

This is often the heart of the marketing mix. However, the product or service must not be a straight jacket constraining that mix. It must be flexible and capable of adoption to the changing needs of the customer.
It is always important to know why customers buy products and what particular features and benefits they value most. A particular product or service might include:- design and technical features, performance, quality, range (size, color etc), maintenance and running cost, safety, before and after sale, product availability and image (fashion).

Even a company selling products will have a strong service element to this component of the marketing mix. Indeed, personal service is a vital way that any small firm can differentiate itself from larger competitors. The personal service and personal relationship build up with the customer is something that large firms find it difficult to replicate and offers one obvious area in which small firms have a competitive advantage.

When translating the features of both the 'core product' and the 'service' element that accompanies it into benefits, you may wonder whether they are real benefits of value to the customer.
The more real, valued benefits that a firm offers, the more likely it is to attract buyers and convert them into satisfied customers who may return for repeat purchase.

This also explains why customers may prefer a particular supplier of an apparently identical product; despite the fact they are more expensive than Rivals. The other benefits offered, such as service, add up to a more attractive and valued benefit package.

ii) Price

Pricing is of course, an important part of the marketing mix. Too many small firms, however, compete primarily on price simply because the other elements in the marketing mix are insufficiently different from their competitors. However, price is more usually a barrier to sales rather than a positive inducement.

The price charged for a particular product or service ought to reflect the value of the ‘package of benefits, to the customer, often the value to the customer for a product or service can be different in different circumstances.

Many firms, of all sizes, use a ‘cost-plus’ pricing formula with this approach you simply add up all the costs and add on a margin. The option of pricing high or ‘skimming may seem strange at first, Higher prices implies lower volume of sales, unless you are able to offer something that is uniquely different from the competition and highly valued by the customer.

However, for many smaller firms lower sales volume is not necessarily a bad thing. It means that greater attention can be paid to quality, customer service and other elements of the marketing mix, there by justifying the higher price. The price charged out to reflect what the market will bear for that product or service. Normally, the market will bear arrange of prices, reflecting different marketing mix offerings. The final decision on pricing, then, is a question of judgment reflecting the value of that mix to consumers.

iii) Promotion

This is concerned with how well a firm communicates its sales message to existing and potential customers. When products or services are very similar, this is often one of the few ways that they can differentiated from the competition.

There are many ways of promoting a business. When a company promotes its products and services directly to potential customers it is called direct promotion. Often this is undertaken through the sales force. It includes:- direct face-to-face selling, telephone selling, direct mail, exhibitions and special demonstrations but this method is expensive.

On the other hand indirect presentation is concerned with the mass techniques of communication. One of these techniques is advertising, which seeks to inform, persuade and remained (reinforce) messages to existing & potential customers. Most small firms start out relying heavily on personal selling, but as they grow the real cost of this activity become more apparent. However it is important that advertising campaigns are properly costed and planned in advance.

Public relation, or PR, is a very good way of getting publicity without paying for it. Most firms have news worthy things happening within them, such as contracts won, new plant or equipment installed, expansion plans, new developments, awards or even local charity work. The big advantage of this sort of publicity is that it is 'editorial' rather than advertising and therefore has more credibility.
Another form of indirect promotion is the sales promotion. This is essentially a short term campaign to influence customers to buy more or to motivate your sales force to sell more. There is a wide range of sales promotions offering money, goods or services as inducements. The essential element is that it is intended to give a short-term boost to sales.

iv) Place (distribution)

The place element of the marketing mix is about getting the goods or services to the right place at the right time for the customer. For a shop that means location, frequently the most important element of the mix for them. For other business it is about physical distribution (moving goods) and distribution channels (which outlets to use). Physical distribution is concerned with transport and it addresses the following questions.

- Should a small firm use vehicles or the train?
- Should it use its own vehicles or hire a carrier?
- How frequently should it deliver?

Distribution channels is concerned with the out-lets you use for selling to customers. Ideally, you would seek to have channels that give you maximum control at the most reasonable cost. However, remember that the choice of distribution channel could create a very real competitive advantage for you.
Many small firms sick to the distribution channels they have traditionally used or know best. In doings so they may be losing out on new market opportunities. It pays to think creativity about all elements of the marketing mix.

5.3. *Market Segmentation*

Market segmentation is breaking down a market into groups of customers with similar characteristics. The key for most small firms is to concentrate their efforts and resources on one-or at most two or three-clearly defined markets. In this way resources can be focused on the needs of that group.
The purpose of segmentation is to find a way of describing groups of customers so that the firm can better communicate with them. This allows

the firm to tailor the marketing mix to the needs of that segment and communicate the offering in an appropriate way, through an appropriate medium.

There are many ways of Breaking down a market in to segments. For consumer markets the most likely way of segmenting a market will be personal characteristics, called demography such as sex, age, socio-economic group, occupation, location etc. for industrial markets the most useful forms of classification are likely to be the type of industry, size of business, location nature of technology, etc,.

5.4 *Market Research*

This is the process of collecting and interpreting market information. At one extreme many small firms rarely undertake formal market research. The best small firms are, however, continually undertaking informal research by talking to their customers and being alert to all the information that they can get about their industry. The key is to make this process systematic and regular, so that, as the business grows, information continues to be gathered & used.

Major sources are customers, the sales force, competitors, distributors, suppliers, trade associations and government bodies. The cheapest source of information is internal information which can be collected from sales records, accounts and employees.

Internal	***External***
Customers	Trade journals
Sales records	distribution
Accounting records	Newspapers and magazines
Sales force	suppliers
Employees	Trade directories
	competitors
	Surveys business
	libraries
	Government publications

Figure 8.1. Sources of market information

5.5 Methods of collecting market information

1. **Personal interviews** – these are for collecting qualitative data particularly on attitudes, behavior and even the language the customer might use. However, interviews are time consuming and expensive.
2. **Telephone interview** – there are increasingly being used simply because they are for cheaper than personal interviews. However, the sample may be biased by considering only telephone owners and it is difficult to contain 'body language' that is possible on interview.
3. **Postal questionnaires** – these are quick & low cost. However, it is easy for the respondent to refuse or forget to respond. Questionnaires are used to collect simple, factual information.

5.6 Marketing Strategies for the small firm

There are some basic concepts that a small firm needs to understand if it is to survive and grow. Based up on these concepts, some marketing strategies would seem to recommend themselves.

1. Competitive advantage

In order to succeed in business, a firm should have some advantages over its competition. Usually these are based up on the different elements of the marketing mix. However, it also pays to understand some of the characteristics of the industry in which it operates because, in certain circumstances, the elements of competitive advantage are not always in the control of the small firm.

Michael porter, in his book on competitive advantage provided five forces that determine competitiveness:

A. **The power of buyers** – This is determined by buyer, firm size and concentration. the volumes purchased, buyer information and switching costs, and their ability to back ward integration.
B. **The power of suppliers** – This is also determined by the relative size of firms and the other factors mentioned above. Thus the small firm buying from a large company is relatively disadvantaged.
C. **The threat of new entrants** – Barriers to entry keep out new entrants to an industry. These can arise because of legal protection (patents etc), economies of scale, product differentiation, brand identify, access to distribution, government policy etc.
D. **The threat of substitutes** – it revolves around their relative price performance, switching costs and the propensity of the customer to switch. For example, a small firm selling a poorly differentiated product in low price, fashion market should find it difficult to compete.
E. **The intensity of Rivalry** – it depends on its newness and growth, its attractiveness in terms of profit and value added, intermittent over capacity, product differentiation, brand identify, switching costs, diversity of competition and exit costs.

The five forces determine industry profitability an in turn are a function of industry structure – The underlying economic and technical characteristics of the industry.

2. Economies of scale

The average size of business varies from industry to industry. For example, the average size of chemical firm is very large; whereas the average size of retail firms is relatively small. The most fundamental reason for these differences in the extent of economies of scale in an industry: that’s how the

total cost per unit produced changes as more units produced. Generally, this can be expected to decline up to some point.

For example, as an expensive piece of machinery is used more fully. However, beyond this point unit costs may be starting to increase. Thus the potential for economies of scale in a high capital intensity industry like chemicals is great, where as in retailing the potential savings are much smaller.

3. Niche marketing

The policy differentiation can be followed most effectively if the product offering is focused on a specific, narrowly defined market segment, thus allowing the elements of differentiation to be greatest and resources to be focused on that target. This focused differentiation is called niche marketing. It involves filling or creating markets that larger firms would find un suitable because of their large investment capacity. It involves creating barriers to entry in that market segment through the reputation or brand loyalty of the firm. The key to successful segmentation is the ability to identify the unique benefits that a product or service offers to potential customers.

One apparent problem with niche strategy is that it is based on a limited market. Frequently, entrepreneur's pursuing niche strategies find further growth by diversification. This diversification is particularly effective if it pursues further niche opportunities.

4. The Life Cycle Concept

It provides a useful framework for looking at the development of either products or services and a small business. A product or service has a life cycle of four stages.

Stage 1- Introduction

This is the stage where the product or service is introduced & encounters a certain amount of consumer ignorance and resistance. Sales are low and growing slowly and profits are low or negative because of the heavy expenses of product introduction. Promotional expenditures are also highest ratio to sales because of the need to inform potential customers.

Stage 2- Growth

This is a period of rapid market acceptance and substantial profit improvement. New competitors enter, attracted by the opportunities. Small firms maintain their promotional expenditures at the same or slightly increased level to meet competition and to continue to educate the market.

Stage 3 – Maturity

At some point, the rate of sales growth will slow, and the product will enter a stage of relative maturity. In this stage; the market becomes saturated and slowdown in sales growth. Profits stabilize or decline because of increased competition. Product sales may simply be for replacement and customers begin switching to other products.

Stage 4 – Decline

After sometimes, sales will star to decline as substitute. Improved products or services become more attractive and the old product becomes obsolete. Sales decline for a number of reasons, including technological advances, shifts in consumer tastes, and increased domestic and foreign competition. Some firms withdraw from the market.

The life-cycle concept helps small firms to interpret product and market dynamics. It can be used for planning and control, although it is useful as a forecasting tool. It can also be a competitive device, in the sense that it allows the firm to compare its sales performance to the industry as a whole. For some products or services the life-cycle can be counted in days. For others, it can span a number of years. It is usually possible to extend the life of a product or service by developing it in some way or expending the market into which it is sold.

5. Diversification Strategies

Diversification is the process of entry in a field of business which is new to an enterprise either in terms of the market or the technology or both. It is a strategy in which the growth objective is sought to be achieved by adding new products or services to the existing ones.

Diversification is possible along two separate paths, first, we can diversify the product (i.e., introduce new products). Second, we can diversify the market (i.e., go in to new markets). In doing so, it is important to bear in mind the risks involved.

For example, we could introduce a new product or service related to our existing product lines, this is a low-risk strategy. Similarly, we may decide to diversify in to completely new markets, either geographically or by type of customer. This would be a major risk, since the business has no experience in this area.

In search for further growth, a business has four options:

1. It can stay with its base product or service and its existing market, and simply try to penetrate the market further. This dealing very much with the familiar and normally the lowest risk option.
2. It can develop related or new products for its existing market and this is called product development.
3. It can develop related or new markets for its existing products. This is called market development.

4. It might try moving into related or new markets with related or new products this strategy involves unfamiliar products & unfamiliar markets with high risk.

Market and product development should be incremental from the familiar to the unfamiliar. Further it is claimed that market developments are to be preferred to product development because new customers is less risky than developing new products. The strategies discussed above are called 'horizontal' strategies. Two further strategies for growth are open to the small firm:

First, 'Backward Vertical integration' – the firm becomes its own supplier of some basic raw materials or services.
Secondly, 'forward vertical integration' – the firm becomes its own distributor or retailer. Both strategies entail new product or service technologies and new customers and are therefore relatively risky. It is generally accepted the vertical integration is not successful, for small firms and that vertical integration should only be a reaction to competitor's activities, for example, to prevent them from controlling raw materials and services.

REVIEW QUESTIONS

1. Define the tem marketing
2. Distinguish customers and consumers .what implication do they have to small business?
3. Discuss the various marketing mix elements
4. Why does a customer buy products?
5. Why do small firms primarily compete on price?
6. What is market segmentation? What significant does it has to small businesses?
7. Why business firms collect market information on regular basis?
8. What are the possible techniques of gathering market information for small business?
9. Discuss the competitive forces that exist in a market as advocated by Michael porter
10. What is niche marketing?
11. What is the role of understanding the product life cycle concept?
12. What the possible diversification strategies for small business enterprises?

CHAPTER SIX

FINANCING SMALL BUSINESS

Chapter objectives

At the end of this chapter, students will be able to;

- ♣ Understand financial requirements
- ♣ Identify the private and public sources of finance available
- ♣ Discuss finance controlling areas and mechanisms

Chapter description

This chapter mainly discusses the reason for why finance is required, the main sources for finance for entrepreneurs, and how an entrepreneur should control finance and the need for financial analysis.

Contents

6.1. Introduction
6.2. Financial Requirements
6.3. Sources of finance
6.4. Control of financial resources
6.5. Financial analysis

6.1 Introduction

One of the most difficult problems in the new venture creation process is obtaining finance. For the entrepreneur, available financing needs to be considered from the perspective of debt versus equity and using internal versus external funds as the funding source .debt financing is a financing method involving an interest bearing instrument, usually a loan, the payment of which is only indirectly related to the sales and profits of the venture. Typically, debt financing (also called asset based financing) requires some

asset (such as a car, house, plant, machine or land) be used as collateral. Debt financing requires the entrepreneurs to pay back the amount of funds borrowed, plus a fee expressed in terms of the interest rate and sometimes points for using or being able to use the money. Whereas equity financing does not require collateral and offers the inventor some form of owner ship position in the venture. The inventor shares in the profits of the venture, as well as any disposition of assets on a pro rata basis. Key factors favoring the use of one type of financing over another are: the availability of funds, the assets of the venture, and prevailing interest rate. Usually, an entrepreneur meets financial needs by employing a combination of debt and equity financing.

6.*2 Financial Requirements*

Small business needs money to finance a host of requirements. In looking at the types and adequacy of funds available, it is important to match the use of the funds with appropriate funding methods.

1. Permanent Capital (equity capital)

The permanent capital base of a small firm usually comes from some form of equity investment in shares in a limited company, or personal loans to or from partner or sale traders. It is used to finance the one- off start-up costs of an enterprise, or major development and expansion in its life cycle. It may require for a significant innovation, such as a new product development.

In some cases, it is required to refinance a firm that has acquired borrowings which are inappropriate to its current situation; short term borrowings, in the form of loans or over drafts, may need to be converted in to more permanent capital as a small firm grows, or runs in to problems.

Equity from private investors may also be sought to take a small firm in to the medium or large size category or as an exit route for the original investors.

Ideally, permanent capital is the only serviced when the firm can afford it; investment in equity is rewarded by dividends from profits, or a capital gain when shares are sold. It is not therefore, a continual drain from the cash flow of a company, such as a loan, which needs interest and capital repayments on a regular basis.

2. Working capital-short-term finance

Most small firms need working capital to bridge the gap between when they get paid and when they have to pay their suppliers and their overhead costs. Requirements of this kind of short term finance will vary considerably by business type. For example, a manufacturer or small firm selling to other businesses will have to offer credit terms, and the resulting debtors will

need to be financed; the faster the growth ,the more the debtors, and the larger the financial requirement.
A retailer, a restaurant, a public house, or other types of out let selling direct to the general public will often collect cash with the sale however.

If they are paying their suppliers on credit terms, the cash flow will be advantageous. In some cases, this will be sufficient to finance the start up of a small firm, so that suppliers are effectively financing the business. However, even these types of business may need working capital to fund temporary losses, caused by seasonal fluctuations, to cope with prepayment of expenses such as rent payable in advance. Although short term finance is normally used to fund the trading of business, it is also sometimes needed to purchase assets, which are short lived, such as company vehicles which may be changed every 2 or 3 years.

3. Asset finance –medium to long term finance

The purchase of tangible assets is usually financed on a long term basis, from 3 to 10 years, or more depending on the useful life of the assets. Plant, machinery, equipment, fixtures and fittings, company vehicle and buildings may all be financed by medium or long term loans from a variety of lending bodies.

4. International trade finance

Exporting brings its own set of money problems. Currency fluctuations, lengthy payment terms and security of payment all give rise to the need for some kind of specialist or export finance.

6.3 Sources of finance

1. Personal investment by owner managers

The most important source of start-up capital comes from owner manager themselves.
It would seem that the level of owner investment is conditioned by two factors:

A) Credit worthiness of the owner

As homes are the major source of guarantee on borrowings the higher value of property, and higher rates of home ownership in more prosperous regions, will allow owners to borrow relatively more money as mortgages or second mortgages to finance their business.

B) **Experience and awareness of sources of funds**

In regions where redundancy from traditional industry sector is a key source of new business information, those people 'pushed' into new ventures as the only realistic alternative employment, tend to have limited experience of financial management, and restricted awareness of possible sources of funds.

2) The business expansion scheme

The objective of the scheme was to encourage outside investment in small firms, by individuals who would remain as investors, not as managers. The incentive for this investment was generous tax relief to help compensate for the higher risks involved.

This was not targeted at investment by owner – manager; the scheme specifically precluded investors from being directors or employees of the business.

3) Venture capital

Some people are endowed with good product ideas, but lack the necessary funds to translate these ideas in to production. The concept of venture capital was evolved to help such persons.

Venture capital is a form of equity financing of projects with high risk and high return. It is means for financing high technology projects. Besides financing high technology, venture capital fosters the growth and development of industries. It helps to convert research and development projects into commercial production.

The concept of venture capital originated in USA. Now it has become a worldwide concept in the field of funding technology based industrial projects. Venture capital funds provide finance for growth businesses, usually through equity capital with some loan element. There are over 100 venture capital companies in UK. Who obtain investment funds from a variety of sources, including pension funds. Insurance companies, investment trusts, regional development and private individuals through the BES.

The best known is probably 3i (investors in industry), established by the bank of ENGLAND and the clearing banks in 1945 to provide finance to growing firms. The venture capitalist provides risk finance, which will come after banks and other preferential lenders in terms of security. The returns sought from the investment will therefore be high: the internal 'rate of return 'targets of most venture capitalists are between 25-60% depending on the risk involved.

The structure of any particular investment will vary but usually involves any combination of three types of capital:

- Equity shares
- Preference shares and Loans

The venture capital fund will wish to see ways of cashing in their investment by selling their shares in the future.

4. Clearing banks

After investment by owner – managers or private individuals, overdrafts and loans from a clearing bank are the next most popular form of small business finance.

Banks and the small firm

The dramatic increase in the number of small business and the self-employed during the 1980's, stimulated the main banks to develop services specifically targeted small firms. Now a day many clearing banks have all now developed a range of products and advisory services to more closely meet the varying needs of small business. For example, if we take the national Westminster bank, in UK, offers free banking for the first year and a range of borrowing options:

- A business start-up loan, with fixed rate of interest and a possible capital repayment holiday for the first 6 months;
- A business development loan for the growing business, with a capital repayment holiday for up to 2 years; or
- A more simple and flexible overdraft.

In addition, they have an extensive network of small business advisory centers, offering personal advice and written information, and the bank is also significant contributor of finance for research into the small firms sector. In UK more recently, the relationship between the major banks and small firms has been given much attention by newspapers and politicians. These could give an idea that other countries such as our country, Ethiopia, can encourage small business by applying similar schemes.

Loan guarantee scheme (LGS)

For those small businesses not able to arrange a bank loan under formal policies, the government's loan guarantee scheme can provide a guarantee of up to 80% of loans under £100,000.

5. Public sector sources

There are a number of central and local government sources of finance for the small business, which represent both equity and short and long-term loan capital

- The Enterprise Allowance Scheme (EAS) operated by the Department of Employment Pays unemployed persons £40 a week for a year if they become self-employed in their own business.
- British Technology Group (BTG) provides finance for innovative small firms requiring funds to develop new or existing products and ideas.
- Development Agencies and Boards have been set up to coordinate new and small business support in their areas.
- Local Enterprise Agencies are coordinated under the 'Business in the community' umbrella, to provide advice and funds for small enterprises, including equity finance.

- The Rural Development Commission has limited funds available to promote small rural firms with specific projects likely to enhance the tourist trade in the UK.
- Tourist Boards encourage the growth of the tourist business, partly by offering loans and grants for specific projects likely to enhance the tourist trade in the UK.
- The prince's youth Business Trust is a charity, which provides finance (as well as advice and training) to young people to set up and develop their own business. It is supported by funds from the E.C, national and local government, as well as companies, and private individuals. The trust has helped over 7000 business through a combination of loans and bursaries to unemployed people aged 18-25, or up to the age of 30 if they are disabled.
- SMART, the small firms Merit Award for research and Technology, offered under the Enterprise Initiative, is a package of advice and help for smaller businesses from the Department of Trade and Industry. The object is to ' inject financial assistance in to viable ideas from small firms are just the critical point- when the idea is still at its embryonic stage and not yet mature enough to interest financiers'.

6. Finance House and Leasing Companies

An important source of either short or medium term asset finance is the form of leasing and hire purchase. Both of them involve regular payments for the use of an asset, but with different ownership implications.

- **Leasing –**allows a small firm to obtain the use of equipment, machinery or vehicles without owning them. Ownership is retained by the leasing company, although in many cases there is a purchase option at the end of the lease period.
- **Hire – purchase**-provides the immediate use of the asset and also ownership of it, provided that payments according to the agreement are made finance houses are the main provides of hire purchase funds. They date back to the last century, when they were set up principally to provide finance for the purchase of railway wagons by colliery owners and coal merchants.

These methods of financing are elaborately explained separately owing to its tremendous importance to setting up a business venture.

7. Factoring

Factoring is a specialist form of finance to provide working capital to young, undercapitalized business. A small firm, which grants credit term its customers, can soon has considerable sums of money tied up in unpaid invoices. Factoring is a method of releasing these funds; the factoring company tasks responsibility for collection of debts and pays a percentage (usually up to 80%) of the value of invoices to the issuing company. The company thus has immediate payment once an invoice is issued although it pays for this service by not receiving the full value of the invoices.

8. Trade –credit

Trade credit is the most widespread source of short-term financing for business. Rather than borrowing money to pay for products or supplies, a company buys on credit from the supplier. The degree of formality in such arrangements may range from a simple handshake to an ironclad written agreement. Most trade credits fall within one of the three categories:

I. **Open-book-credit-**a majority of all business transactions involving merchandise are financed through 'open-book-credit' sometimes referred to as an 'open account'. This is an informal arrangement whereby a purchaser may obtain products before paying for them. Under this type of arrangement, the business orders goods from the supplier, who delivers them. The amount of the purchase is then charged to the business's (buyer's) account. Companies using the open book credit system indicate credit or repayment terms to the customers on that accompany delivery. Open book credits are usually extended for a short period of time usually for 30 days and customers are expected to pay their bills by the end of this period. However, many businesses try to pay before the end of the credit period, because suppliers in order to encourage speedily repayment offer special discounts for early repayments.

Invoice terms are usually stated in numbers, such as '2/10; net 30' which means a buyer can take a two percent discount if the invoice is paid within ten days; if the discount is not taken, the full bill is due in 30 days.

II. Promissory notes –not all business people are comfortable with the relative informality of open book credit. They prefer the security of written agreement to repay, signed in advance by the consumer they are supplying. One such agreement is a promissory notes, un unconditional written commitment drown up by the borrower, who promise to pay the creditor affixed sum of money of money on a specified date in return for immediate credit. Often there is an interest rate on promissory notes, indicated on the note itself.

The person who promises to pay the amount specified in the note is the **maker**. The person to whom the note is payable is the **payee**. If the creditor needs the money before the due date on the note, he can obtain it in advance without breaking the written term of the agreement. The creditor or payee needs only sign on the back of the note (endorse it) and take it to the bank. The bank then pays the face value of the note, minus fee for this service. This procedure is called **discounting a promissory note**. The bank goes on to collect the full amount on the note for itself when the notes fall due. The amount of the discount depends on the rate of interest the bank is currently charging.

III. Trade draft (commercial draft) and acceptance: draft and acceptance can be particularly use full when the merchant is dealing with poor or unknown credit rating or with foreign customers whose credit position are difficult to check.

A commercial draft or trade draft is similar to a promissory note except that the person who is to receive the money initiates it; i.e. the customer (borrower) initiates promissory notes, where as the trade draft by the supplier.
A trade draft in an order to pay a stated amount of money within a certain number of days, as drawn up the creditor (the drawer). The supplier attaches the trade draft to the shipping document (the bill of lading). The draft is an order for the customer (the drawee) to pay a stated amount within a number of days. The customer must sign or accept the draft in order to receive the merchandise. By signing the draft, the customer agrees to pay the designated sum for the merchandise. The signed trade draft, which known as trade acceptance is returned to the supplier.

9. Export finance

The most important step in financing international trade is ensuring full and prompt payment. The export guarantee department – provide credit insurance that gives cover in the event of none payment by an overseas customers. They offer a variety of insurance. Schemes, which a small firm can assign to a bank or other lending body in order to obtain export finance.

6.4 *Control of financial resources*

1. Financial problem

In the first hurdle for small business is to ensure the availability of the appropriate amount and type of funds, the next step is to optimize the use of those financial resources by effective planning and control.
Fast growing small business have particular problem in controlling their finance. Growth brings frequent change to the internal structures and external environment of a small firm. It is often difficult to ensure that financial control system keep pace the changing circumstance.
For example, a small firm, which historically traded directly with consumer, markets, expanded by setting up distributers both in home and overseas. This leads to the development of debtors, as the distributers were given – credit and rapid increase in stocks which were needed to service the new out lets. The small firm didn't have control system in place to cope with these new demands and soon ran into liquidity problems.
The small business is likely to be confronted by a variety of financial problem as it advances through its life cycle. The Figure bellow illustrates some of the potential issues in each stage.

The financial life cycle of small business

Stage	**Likely source of finance**	**Financial issues**
Conception	Personal investment	Under capitalization,

		because of inability to raise finance
Introduction	Bank loans ,drafts	Control of costs and lack of information
Development	Hire, purchase, leasing	'Over trading' liquidity crisis
Growth	Venture capital	Equity gap appropriate information system
Maturity	All resources	Weakening on return investment
Decline	Sale of business/liquidation	Finance withdrawal. Tax issue if a business is sold

In the early stages, the lack of track record can hinder raising there the required money, and lead to an undercapitalized business. As the business begins to trade, it will have little experience on which to base forecasts for planning purpose, and vital information may therefore lacking. Cost will be incurred as the company finds its feet, for which there may be in adequate control of system at this stage.

Once full developments gets underway and sales grow, over trading can result, with debtors and stock increasing rapidly with as negative cash flow builds up into liquidity crises.

Finally the business matures and although cash flow at this stage is positive, profitability levels off, and return on investment may worsen. As maturity turns to decline, the business may be sold, or go into liquidation; new partners may buy in to the business in an attempt to kick it back into growth. Over draft facilities and other renewable finance may be withdrawn at this stage as confidence. If the business is sold, taxation of any capital gains requires careful consideration by the vendor.

2. Cash flow _debtors and stock

Financial management in small firm starts with the management of the cash flow. Cash is critical to survive, representing the lifeblood, which enables the activities of the firm to be undertaken. It is easy for fragile cash resources of small business to become 'locked up' in unproductive areas, such as debtors, work in progress and finished stocks. Any areas when funds become locked-up require effective management to minimize the extent of the' lock –up. '

Debtor's control

Debtors can hurt small business into major ways: Firstly, they absorb cash and effectively increase the funding requirement of a small firm. Secondly,

the longer the debt is alive, the greater the risk of bad debt. Particularly, in recessionary times, “the risks of having invoices which go unpaid are high. The impact on a small firm can be disastrous, even causing the failure of the business. These problems are unique to small firms, but they can be accentuated by the smallness of an operating unit in any of the following ways:

- The costs of chasing slow players or bad debts may be greater than the amount of money being pursued. This is a particular problem for companies with a large number of small customers;

For example, a small firm mail order firm sells products priced under $50 on 30 day trial basis, as parts of its marketing approach. It quickly generated over one thousand customers in this way, and found that considerable time and money had to be spent to control a sales ledger with this profile.

- The time taken to establish the credit worthiness of a potential customer may be longer than the sales process. Keenness to win an order and to jeopardize it by lengthy credit checks may cause an owner manager to accept imprudent credit risks.
- The small firm may not have the control systems to identify individual debtor problem before they become critical. An essential part of any management accounting system is an analysis of debtors by their age, as well as their amount, so that appropriate action can be triggered to chase up slow players.

This rigorous pursuit of payment, which gradually escalates the tone of requests from polite reminder to threat of legal action, is an unfortunate but essential element in small business management today.

To be done effectively, accurate information on customer’s indebtedness is required on a very regular basis. For example, a small business set up a debtor control system using a serious of standard letters, which were sent to customers once the age of their debt passed a certain number of days. These letters were triggered by information from the computerized accounting system, which produced an aged debtor-analysis. The firm was not large enough to employ full time accounting staff, and therefore used an external book keeper who came in near the end of each month to process invoices and payments. Unfortunately this system generated considerable confusion and aggravation, as the information on customer’s payments was invariably out of date. Customers become irritated by threatening letters after they had actually paid. Also, so much time was wasted chasing payments received but not entered the system that serious problems were not attended to as they developed.

Management of stock

- Sock represents a poor investment for a small firm's financial resource. Stock surpluses earn no money and risk of deterioration if not used quickly. However, the consequences of running short of stock can be even more punitive; if orders go unfulfilled, even lost of sales may occur because of shortage of stock. Finally, the effect on cash flow can be disastrous. Stock management therefore about balance and optimization of resources; weighing up the risk of running out versus the costs of paying it too safe. Stocks need controlling in three areas:
- Raw material stock-represent what a manufacturer needs to produce its own products and services.
- Work-in-progress (WIP)-is stock which is currently being worked on, but is not yet salable as finished items.
- Finished stock-is ready for sale, but either awaiting shipment to a customer or unsold.

Keeping All these types of stock to an optimum level is a difficult balancing act, particularly in industries where demand is unpredictable and often short lived (e.g fashion and toy industries).

Liquid assets and current liabilities

A good measure of the health of a small firm's cash position comes from an estimate of its liquid assets and current liabilities. Assets which can be quickly turned into or already represented by cash and liabilities which should be paid in the short term (12 months). If small businesses current liabilities exceed the total of liquid assets, then problems may be just around the corner.

3. Costs and profits

Profitability and cash flow are sometimes confused by owner managers, struggling to come to grips with the financial management of their business. Profits and losses are theoretical figures representing the difference between the total earnings (whether received or not) and total expenditures (whether paid for, or not) incurred by a small firm in achieving those earnings. Profits or losses should, of course, be translated into cash surpluses or deficits, but this may take some time. Profitability can be improved in a large variety of ways, but they can be classified under three headings:

- Reduction of costs
- Increase of costs; and
- Increase of sales volume

Costs are further classified as fixed and variable.

- **Fixed costs**-remain u changed in the short term; they are fixed in the sense of not varying with the volumes of goods or services sold. Fixed

costs are the over heads of a business, comprising such expenses as management and the costs of finance and depreciation of assets.
In the long term, fixed costs do of course vary. The resources represented by the over heads of a business can only cope with so much before they need to be increased. People and premises, for instance, can only manage up to a certain capacity before new resources have to be added.

- **Variable costs**-do change directly in the line with how much is sold. They variable in the sense of varying according to the volume of goods and services sold. Variable costs include raw materials used in production by a manufacturer or the costs of stock sold by a retailer.
- **The gross margin**-of a business represents its sales revenue less any variable costs.

A careful presentation of a gross margin by significant product lines is an important cost control and pricing tool. It is also used to determine the breakeven point of a business, as this is reached when the gross margin generated by sales is sufficient to cover the fixed costs of the business.

- **Prices and volume**- profitability also influenced by prices charged and sales volumes achieved.

6.5 Financial analysis

Management accounts and forecasting

Small firms differ greatly in their approach to the provision of accounting information, and the use of forecasts and budgets for planning and control of the business. Some studies suggest that there is a considerable gulf between 'entrepreneurial' companies aiming for high growth and 'firms' who have no great ambitions to grow other than the required to survive whilst there are less differences between the provision of historical accounting information, the 'entrepreneurial' small firms much make greater use of forecasted financial information than the 'passive' firms.

The three most widely used financial summaries are:

- Profit and loss account or income statement
- Cash flow and
- The balance sheet

The profits and loss account- show how a business is doing in terms of sales and cost- and the difference is profit or loss. It is a moving picture and can be used to forecast and monitor results on monthly basis / for a longer period.
The cash flow-is perhaps the most important summary for a young firm as it indicates the movement of cash into and out of the business. It differs in the important respect of reflecting credit given to customers and received from suppliers, as well as the amount of money invested in a business or

borrowed by it. Because of their importance, cash flows are used on a very regular weekly or monthly basis.

Balance sheet-is a snapshot, rather than a moving picture, as it represents a summary of what money has been spent by a business and what is has been spent on. It is usually an annual summary of the use and source of funds in a company.

DISCUSSION QUESTIONS

1. Why small businesses need money? Discuss
2. Explain the difference between debt capital and equity capital
3. Identify and explain the sources of funds for small business
4. Which source of capital is needed for financing start-up, expansion, expansion and development activities of small business?
5. To which activities or conditions of the small business do think is working capital most needed?
6. Discuss the financial problems small business may face at the conception stage, introduction stage, development stage, growth stage, maturity stage and declining stages of financial life cycle.
7. 'Cash is critical to survival, representing the life blood of small businesses. Do you agree? Discuss
8. In what ways do you think debtors can hurt small businesses?
9. What are the control areas that small businesses should exercise over their stocks?
10. Discuss the ways how profit can be improved in small business.

CHAPTER SEVEN

GROWTH STRATEGIES FOR SMALL FIRMS

Chapter objectives

At the end of this chapter, students will be able;

- To discuss motivations that drive small firms for growth.
- To know where to look for (or how to create) possible growth opportunities.
- To identify the merits and demerits of each growth strategy.
- To understand the implications of growth for small businesses.

Chapter description

This chapter mainly discusses the four major strategies of growth in small business strategies. These strategies are classified into two as internal and external growth strategies. Expansion and diversification are said to be internal growth strategies while mergers and sub-contracting are external ones. Brief analysis about the weaknesses and strengths of each strategy is presented in this chapter.

Contents of the chapter

7.1. Introduction
7.2. Need for growth
7.3. Types of growth strategies

- ♣ Diversification
- ♣ Expansion
- ♣ Mergers and
- ♣ Sub – contracting

7.1 Introduction

The growth of small business is similar to that of a human being who passes through the stages of infancy, childhood, adulthood and old age. An enterprise may be considered growing when there is a permanent increase in its sales turn over, assets, volume of output, etc. Business growth is a natural and on -going process. Many business firms started small and have become big through continuous growth. But growth may be restricted by constraints of market demand, finance, technology, management skills etc. a successful new entry provides the opportunity for the entrepreneur to grow his/her business. For example, introducing a new product into an existing market provides the opportunity to take market share from competitors; entry into a new market provides the opportunity to service a new group of customers, and a new organization has a chance to make and built upon its first sales. Because growth makes a firm bigger, the firm begins to benefit from the advantages of size. So, higher volume increases production efficiency, makes the firm more attractive to suppliers, and therefore increases its bargaining power. Size also enhances, the legitimacy of firms, because those firms are often perceived by customers, financiers, and other stake holders as being more stable and prestigious.

7.2 Need for growth

In modern business, very few firms remain static for long. Most of the firms are in a state of continued flux, either expanding or contracting but always changing like time. Business firms grow on account of several factors. The important motives which drive business firms towards growth are the advantages of growth which are;

1) **Survival**

Severe competition forces a firm to grow and gain competitive strength. Any business firms that fail to grow cannot survive for long. With increasing competition and shrinking profit margins, firms have to grow in order to maintain their existence. In a growing industry, a firm has to grow just to retain its present position. A growing firm tends to be an innovator and it can easily face business risks. It can easily absorb the shocks of market forces. Growth provides protection or security against period's adversity such as depression. By diversifying the range of its products and markets, a firm can meet competition in the market and minimizes its risks. Thus, growth is a means of survival in a challenging and turbulent environment.

2) Economies of scale

Large scale operations provide several economies in production, marketing, finance, and management. A large firm enjoys the advantages of bulk purchase of materials, strong bargaining power, spreading of overheads, well organized promotion campaigns, cheaper finance, automation, expert management, etc. These economies result in reduction in per unit cost of operations and increase in profits.

3) **Expansion of market**
Increase in demand for goods and services have led business firms to expand in size. Population explosion and transportation led to widening of markets which in turn resulted in mass production. Business firms grow to cater to larger markets and to meet the increasing demand. Expanding markets provide opportunities for business growth.

4) **Owners mandate**
The owner of a company gets the ultimate benefit of growth in the form higher dividends and rise in the market value of shareholdings. Therefore, they may direct the management to ensure growth of the company through continuous ploughing back of profits instead of distributing the entire earnings. Capable management may on its own like to take carefully calculated risks and expand the size of the company.

5) Technology
Business firms also grow in order to reap the benefits of modern technology. Many firms invest in research and development to develop new products and new techniques. Only a large firm can take full advantage sophisticated machinery and equipment. Rationalization and automation result in more efficient use of craze for power by building business enterprise. They take pride in the growth of firms established by them. Other personal factors such as personal ambition, exceptional organizing ability, strategic genius, etc also lead to growth of firms.

6) Government policy

Generally, business firms operate under a plethora of government controls. Government may provide several incentives in the form of subsidies and tax concessions to industrial units in backward areas and those producing goods for export purposes. A firm may grow to face government controls or to secure these incentives.

7) Self sufficiency

Some firms grow to become independent in terms of marketing raw materials or marketing of products. They integrate the various stages of industry or acquire other firms to gain control over the supply of raw materials and marketing of finished products.

7.3 TYPES OF GROWTH STARTEGIES

The main strategies for growth are as follows

1. Expansion
2. Diversification
3. Mergers and
4. Sub – contracting

1) Expansion

Expansion and diversification are forms of internal growth. Internal growth implies increase in the scale of operations without joining hands to the other firms. The firm expands its product market scope. Expansion may take place in the following forms;

A) Market penetration; is increasing the sale of existing products in the existing markets.
B) Market development; is exploring new markets for existing products.
C) Product development; is developing new or modified products for sale in the existing markets.

Advantages of expansion

1) Expansion can be financed from the firm's own funds.
2) No major changes are required in the organization structure and management system of firms.
3) Better utilization of existing resources becomes possible.
4) The expanding firm can better face competition in the market.
5) Expansion provides economies of largo scale operations.

Limitations of expansion

1) Growth is slow and takes time
2) It is not always possible in the present product market
3) A business firm may not be able to exploit many business opportunities by confining its operations to the existing products and markets.

Practical problems in expansion

1) Scarcity of funds 2) Marketing 3) Risk 4) Diversification

Is the process of entry in the field of business which is new to an enterprise either in terms of markets or technology or both.

Advantages of diversification

1) Reduction in risk due to spreading
2) Stability through capacity to absorb shocks of business cycle
3) Wide scope for growth and profitability
4) Better use of existing facility
5) Competitiveness

Disadvantages

1) Reorganization is necessary
2) Difficulty in coordinating diverse businesses.

Diversification is suitable for the following reasons

- When the firm can't attain its growth strategies by expansion alone.
- When diversification promises greater profitability than expansion.
- When the financial resources of the firm are much or excess of the requirement of expansion.

Types of diversification

There are four types of diversification

1) Horizontal integration
2) Vertical integration
3) Concentric diversification
4) Conglomerate diversification

1**) Horizontal integration**

In this type of diversification, a company adds up some type of products at the same level of production and marketing processes. It may happen internally or externally. Internally, a company may decide to enter a parallel product market in addition to the existing product line. Externally, a company may combine with competing firms. Two or more competing firms are brought together under single ownership and control.

Advantages

A) Wasteful competition among the combining firms is eliminated.
B) It provides economies of large scale operations.
C) It provides greater control over the market and increases the competitiveness of the company.
D) It permits the firm to influence supply and price of the product.

Disadvantages

A) The firm is not assured of supply of raw materials.
B) The company may acquire monopoly may used to exploit consumer and labor,
C) When several firms combine to form horizontal integration, there is danger of over capitalization
D) The management of the firm may become bureaucratic and inflexible

2. Vertical integration

In this type of growth strategy new products and services are added which are complementary to the existing product or service line it may be two types.

A. **Backward integration:** it implies moving towards the source of raw materials. Also called upstream development, it is aimed at moving lower on the production process so that the firm is able to supply all raw materials or basic components.

Advantage

A) It helps ensure regular supply of raw materials or components.

B) It improves ensures quality control over imports for the final product.
C) It facilitates higher return on investment for the company as a whole through better use of overhead facilities.
D) It improves the company's power of negotiation with suppliers on the basis of known costs.
E) It saves indirect taxes payable on the purchase of inputs.

Disadvantages

A) The firm losses the opportunities of purchasing at a lower cost from technically more efficient suppliers.
B) Changing economic condition affects the main product markets may cause a magnified effect on the production of inputs.
C) When the divisions using the inputs don't have the freedom of comparing market conditions of supply, the problem of transfer pricing may become acute.Etc.

B. Forward Integration

Is involves the entry of a firm into the business of finishing, distributing, or selling its existing products. It is also known as downstream expansion. It refers to moving higher up in the production or distributing processes towards the ultimate consumer. The firm develops outlets for the use or sale of its own products.

Advantages

A) It enables the firm to gain greater control over sales and prices of its products.
B) It improves the scope of quality control because the firm's own retail stores serve as better source of customer feedback.
C) The firm can increase its profits by eliminating middlemen and by reducing the costs of production Etc.

Disadvantages

A) It reduces the flexibility of operations.
B) The proportion of fixed costs in the firm's costs increases, as a result of the firm is exposed to greater cyclical changes in earnings Etc.
C) It is very difficult to efficiently manage an integrated firm because every business has its own structure, technology, and problems.
D) It requires high capital investment. Etc

3) **Concentric diversification**

When a firm enters into some businesses, which is related with its present business in terms of technology, marketing or both, it is called concentric diversification. In technology related concentric diversification new product or service is provided with the help of existing technology. In marketing related concentric diversification, new product or service is sold through the existing distributing system. In technology and marketing related concentric diversification, both existing technology and distributing system are used for the new product or service.

Concentric diversification may be employed for the following purposes;

A) To counteract cyclical fluctuations in the present products or services.
B) To utilize the cash flows generated by the existing products or services.
C) To face saturation of demand for present product or services.
D) To gain managerial expertise in the new field of business and
E) To capitalize on the reputation of present product or services.

4) Conglomerate Diversification

In this growth strategy a firm enters into business, which is unrelated to its existing business both in terms of technology and marketing. For example, Shri Ram Fibers Ltd. (Indian) is a conglomerate carrying on business in nylon industrial yarns, synthetic industrial fabrics, engineering plastics, flow carbon, refrigerance, ball and needle bearings, auto electicals, hire-purchase and leasing, and financial services.
Conglomerate diversification strategy may be adopted for the following reasons:

(a) To achieve a growth rate higher than what can be realized through expansion.

(b) To make better use of financial resources with retained profits exceeding immediate investment needs.

(c) To avail of potential opportunities for profitable investment.

(d) To achieve distinctive competitive advantage and greater stability.

(e) To spread the risk, and

(f) To improve the price earnings ratio and market price of the company's shares.

External Growth Strategy (Joint Ventures, Mergers, or Takeovers)
External growth occurs when two or more firms combine together in one firm. It is also called integrate growth strategy.

Advantages
Integrative growth strategy has the following advantages:

1. Growth is very fast and quick.
2. The firm gets running business units.
3. The strategy offers economies of scale and control over the market.
4. Wasteful competition can be eliminated.

Disadvantages
Integrative growth strategy suffers from the following limitations:

1. Large amounts of financial resources are required to take over running units.

2. Drastic changes are required in the organization structure and management of the firm.

3. Co-ordination and control of integrated units becomes very difficult.

4. Frequent takeovers my create uncertainty and instability in the economy.

Integrated growth strategy may take the form of Joint-venture, merger or takeover.

i. Joint Ventures

When two or more independent firms together establish a new enterprise, contribute to the total equity capital and participate in its business operations, it is known as a joint venture. A joint venture is a temporary partnership or consortium between two or more companies for a specified purpose. Firms within a country as well as firms in different countries may participate in a joint venture.

Advantages

Joint ventures are set up for the following reasons:

1. A joint venture between two or more companies within the same country helps to reduce competition or influence suppliers.

2. High risks involved in new ventures can be reduced through joint ventures.

3. Small firms can compete with large firms by joining hands.

4. The foreign partner in a joint venture can provide advanced technology and technical knowhow not available within the country, Maruti Udyog Ltd.

5. The import content of a project can easily be financed through equity participation by the foreign company.

6. Multinational corporations can enter a country more easily through joint ventures than by setting up branches or subsidiaries.

7. Joint ventures help reduce production and marketing costs through higher sales volume.

8. Risk of business is shared among partners. Many joint ventures have been set up in construction industry for this purpose.

9. A joint venture can provide the benefit of synergy. According to Grucker, joint venture is the most flexible instrument for making the fits out of misfits. The distinctive competence of two or more independent firms can be pooled together.

10. The amount of investment in joint venture is contributed by two or more firms. As a result each partner has to contribute less than when he has to set up the venture alone

Disadvantages

The main problems of joint ventures are as follows:

1. Problems often arise in equity participation because both the local partner and the foreign partner desire to have majority stake in the joint venture.

2. Often there are legal restrictions on foreign investment. Some countries set a limit of permissible foreign shareholding in the local companies.

3. Differences in cultures and stages of economic development of the countries to which the parties belong often create conflicts.

4. Joint ventures between unequal partners often tantamount to quasi mergers and may attract anti-monopoly regulations.

5. Lack of proper coordination among partners may affect the efficient functioning of a joint venture.

Joint ventures are likely to be more appropriate under the following conditions:

1. When an activity is uneconomical for a single firm.

2. When the risk of business has to be shared and reduced for the participating firms.

3. When the distinctive competence of two or more firms can be brought together.

4. When setting up a venture requires overcoming hurdles such as import quotas, tariffs, nationalistic political interests, and cultural roadblocks.

Thus joint ventures are an effective growth strategy when development costs have to be shared, risks are to be spread out and expertise has to be combined to make effective use of resources.

Strategic issues in joint ventures: The major decisions that should be carefully taken in a joint venture are given below:

i. **Objectives of joint venture:** first of all the basic objective of joint venture should be spelled out clearly. The interests of two partners may not be identical and compatible. Therefore, basic differences in their objectives should be stated in advance. A way to break the disagreement should be built into the joint venture from the very

start. Even provision can be made for arbitration and arbitrator acceptable to both the parties can be named.

ii. **Choice of partner:** several criteria may be used to select a partner for the joint venture. These are: financial capacity, technical capacity, management competence, etc. in addition the intention and sincerity of the partners should be considered.

iii. **Pattern of shareholding:** an explicit provision should also be made for disinvestment of shareholding by the government/foreign party after certain period of time. Key consideration in dividing foreign equity participation is the inflow of foreign technology on continuous basis and discharge of export obligation and the government policy.

iv. **Management pattern:** the joint venture should be autonomous. The composition of the board of directors may be decided in the light of choice of partners, shareholders pattern, etc.

ii. Merger

Merger is an external growth strategy. A merger means a combination of two or more firms into one. It may occur in two ways:

a. Takeover or acquisition of one company by another, and

b. Creation of new company by complete consolidation of two or more units. The former is called absorption where as the latter is known as amalgamation.

Types of Mergers

Mergers are of four types:

1. ***Horizontal mergers****:* these take place when there is a combination of two or more firms engaged in the same production or marketing process. For instance, Brook Bond and Lipton India Ltd. Merged together and formed a new company. 'Brook Bond and Lipton India Ltd.' (BBIL).

2. ***Vertical Mergers****:* It takes place when the combining firms are complementary to each other either in terms of supply of inputs pr marketing of output. For example, a footwear company may take over a leather tannery.

3. ***Concentric mergers:*** when the combining firms are similar either in terms of technology or marketing system there is concentric merger.

4. ***Conglomerate mergers:*** it occurs when two unrelated firms combine together, i.e., a footwear company combining with a cement firm.

Why Mergers?

Buying Firm's view point	Selling Firm's View Point
1. To gain quick entry into new markets and industries. 2. To achieve faster rate of growth 3. To diversify quickly 4. To reduce competition and avoid dependence 5. To gain tax benefits 6. To achieve synergistic advantages 7. To have quick access to research and development and other facilities. 8. To fill the gap in the existing product line. 9. To stabilize sales and profits 10. To increase the value of company's shares.	1. To turn around a sick unit. 2. To increase the value of the owner's stock. 3. To increase the growth rate. 4. To acquire resources for stability operations. 5. To deal with problem of top management succession. 6. To reduce tax burden.

Advantages

Mergers are used due to the following reasons:

a. A merger provides economies of large-scale operations.
b. Better utilization of funds can be made to increase profits.
c. There is possibility of diversification.
d. More efficient use of resources can be made.
e. Sick firms can be rehabilitated by merging them with strong and efficient concerns.
f. It is often cheaper to acquire an existing unit than to set up a new one.
g. It is possible to gain quick entry into new lines of business.
h. It can provide access to scarce raw materials and distribution net work and managerial expertise.

Disadvantages

Mergers are not always successful due to the following drawbacks:

a. The combined enterprise may be unwieldy. Effective coordination and control becomes difficult. As a result efficiency and profitability may decline.

b. Mergers give rise to monopoly and concentration of economic power, which often operate against the interest of the society and the country.

Sub-Contracting

Sub contracting hiring another firm to perform some of the manufacturing process or to give sub assemblies that will be included in the finished product. Such contracting is also used t describe contractual arrangements between government agencies and industrial concerns. For example, civic authorities enter into sub-contracts with business concerns. Under such contract business firms carry out the specified work on roads, parks, etc. civic authorities in exchanging of specified fee.

Large business firms similarly assign some of the jobs to small scale units. These jobs may involve some manufacturing or office work. In case of manufacturing work, it may be industrial sub-contracting while in the other cases it is known as commercial sub-contracting. Small-scale firms play an important role in sub-contracting and thereby serve as feeders to large-scale industries.

Sub-contracting has several advantages. First, it is the fastest method of increasing output. It enables the contractor to use technical and managerial skills already existing with the sub-contractor. It avoids the need of setting up new plants and equipment, which involves time and expense. Secondly, sub-contracting saves the buyer from incurring investment in specialized machinery and equipment, which may not be required for regular production. Thirdly, sub-contracting may enable the contractor to buy the components at a cost lesser than that of manufacturing. Lastly, sub-contracting, checks over-expansion of productive facilities in case of temporary demand.

Sub-contracting May, however, be unsuitable in case contractor requires the inputs on a large scale and on regular basis. Same is the case when the

contractor can manufacture the component at a cost lesser than the price charged by the sub-contractor. Sub-contracting provides business to small-scale firms and helps in their development.

DISCUSSION QUESTIONS

1. **What do you understand by business growth? Explain the need for growth of small business firm.**
2. **Define the terms ‘growth strategy’. Describe the various growth strategies adopted by business firms, giving the merits and demerits of each strategy.**
3. **Why do business firms grow?**
4. **Discuss the advantages and limitations of diversification as a strategic growth**
5. **Briefly explain horizontal versus vertical integration**
6. **What are the suitable conditions to implement diversification growth strategy?**
7. **What are the alternative strategies available to a small entrepreneur for the growth and expansion of business?**
8. **What are the practical problems faced in expansion and diversification?**
9. **Explain the different types of mergers.**
10. **Define the term sub-contacting; what is the role of sub contracting for business firms?**

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Evaluation Mechanisms

Project Work (Preparing a business plan) (Individual).....30%
Final exam.....70%

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