Economics, Management and Entrepreneurship
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Lecture - 48
Starting a New Company and Small-scale Industrial Undertaking

Good afternoon. Welcome to the 48th lecture on Economics, Management and Entrepreneurship. In our last lecture we looked at the various forms of ownership starting from sole proprietorship through partnership, cooperatives, private limited companies, public limited companies, section-25 companies and franchises. So we have seen what are the different characteristics of each of these forms of ownership.

Today, we shall talk about the different procedurals and steps that require to start a new company and also we shall discuss about Small-scale Industrial Undertakings and provisions for these small-scale industrial undertakings in our country. So first we shall devote some time on the steps and procedurals for starting a new company.

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Now there are various activities before one can start a new company. But the important activities are the following. Making a plan, creating a business plan basically and deciding which product or service the company will be engaged in that is making a product choice. Setting up infrastructure then the legal procedure naming and registering a business, choosing a form of business organization, choosing where the industrial be located.

Pricing the product, other regulatory requirements particularly environment. Financing a startup business. Sourcing process, raw materials, machinery and equipment, and hiring human resources, so these are some of the important activities that are require to start a new company. Let us see one by one. Let us talk about them.

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When we have a business plan what are the different paragraphs? The first is the cover page that should mention the Company's name, address, telephone number, fax number, e-mail and website address, the name and designations of the contact persons, names of funding organizations and also the company's logo. So these are expected on the first few pages of a business plan.

This will be followed by table of contents were the title of each section along with the section number should be mentioned. That will be followed by an Executive Summary giving summarized information on the kind of business, profile of the company's management, financial requirements, budget allocation, objectives of the company both quantitative and qualitative, some market analysis, and the influence on environment.

These are the summarized information to be given in the executive summary. It can go for one or 2 pages. This will be followed by a detailed exposition of the actual plan. The development and production in these details of the stages of development and production of the product and services that the company is trying to engage itself in must be given and how at each stage money will be allocated, how long it will take to achieve objective of each stage. This should be spelt out in detail in this particular or paragraph.

Next the resource requirement, resource requirement for maintaining quality for marketing the product and service to target the market. The communication strategy including advertising, branding and packaging, sales forecast, financial plans, human resources, the form of business, critical risks that are expected to be faced, conclusion and appendixes must be mentioned there. And one should be very careful about the format of a plan and its presentation.

It should be properly written and it must be edited before the plan is submitted or circulated are given outside. So these are different heading in which the plan should be mentioned.

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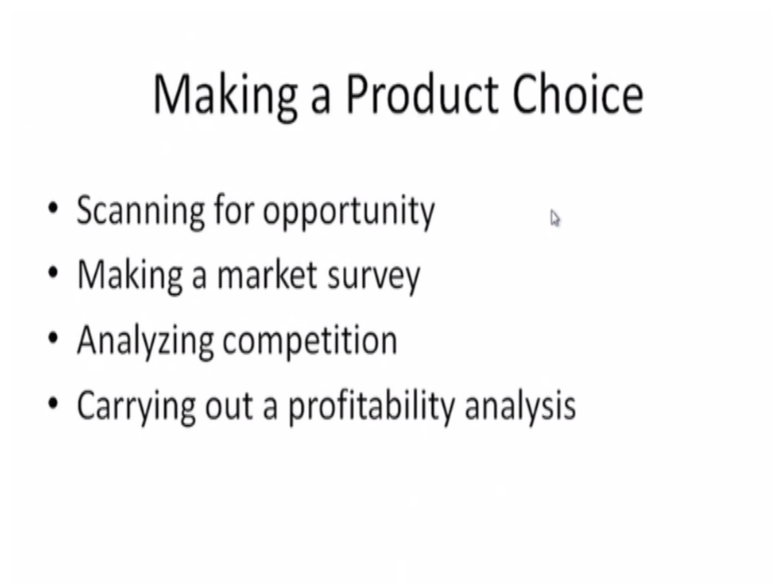

Making a product choice is a very important aspect of the plan naturally. An entrepreneur has to scan for the opportunity in a market carry out a strong market survey, analyze a competition and make a profitability analysis then only the product should be selected. Normally a number of alternatives are surveyed or rather explored and the profitability analysis made on each of the product alternatives to finally decide which product the company should manufacture.

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Now there is a reserved list of products for small-scale sector in India. Reservation of products for exclusive manufacture in the small-scale sector, of course the large and medium units can also manufacture such reserved items provided they undertake to export 50% or more of their production.

Then they can also pickup these products, the products are Pickles and Chutneys, Bread, Mustard Oil, Groundnut Oil, Wooden Furniture and Fixtures, Exercise books and Registers, Wax candles, Laundry soap, Safety matches, Fireworks, Agarbatti, Glass bangles, Steel Almirah, Rolling Shutters, Steel Chairs and Tables, Steel Furniture, Padlocks, Stainless Steel Utensils and Domestic Utensils made of aluminum.

Now these products are exclusively made for small-scale sector. Of course the large and medium units can be manufactured provided the export at least 50% of their production. This is the reserved list of products.

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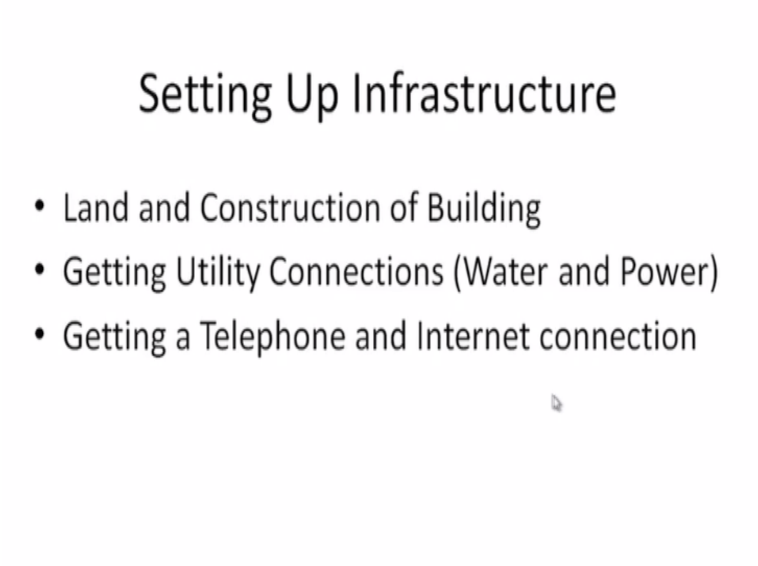

Now setting up infrastructure means land and construction of building, so how much land is required keeping future expansion in mind and buildings also, details of that should be given. What set of water and power connections are require where from they will be procured that also should be mentioned. They are the utilities. Telephone and internet connection, about that also the plan should make a mention.

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Now naming and registering a company. Incorporation of a company is governed by the Companies Act 1956. We already have discussed about this. The act is administered through the Ministry of Corporate Affairs MCA-Ministry of Corporate Affairs. And the Offices of Registrar of Companies that are located in different states and union territories and other such government institutions.

Now the Registrar of Companies controls the task of incorporation of new companies that means formation of companies and the administration of running the companies is overseen by the Registrar of companies. For registration and incorporation of a company an application has to be filed with the Registrar of companies. So every new company has to file its application with the Registrar of companies in that state.

Application for a registration of a company is accompanied by the selected names that is name of the organization, Memorandum of Association and Articles of Association, and other such necessary documents that are require to apply for the Registrar of companies and they must be located in the state in which the company is proposed to be incorporated meaning its head office will be stationed.

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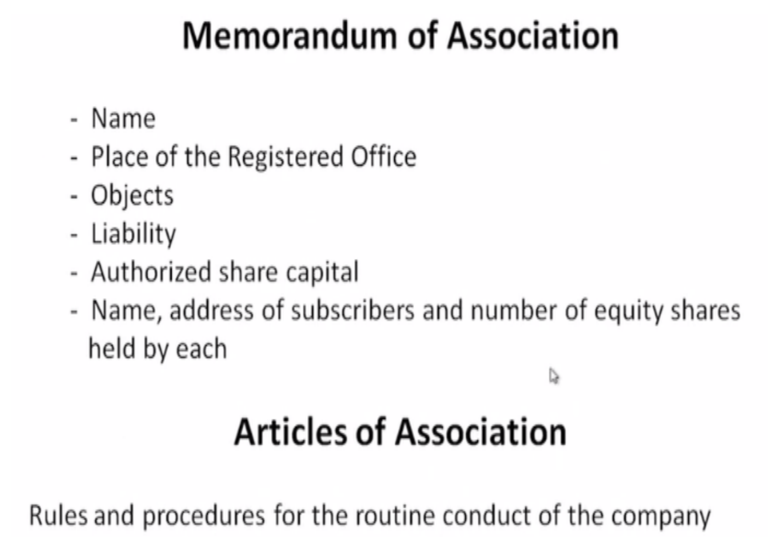

Now what is the meaning of Memorandum of Association. In a memorandum of association, the name of the company, the place where the registered office will be located, the objectives of the company, whether the liabilities are limited it must be properly mentioned. And what is the total authorized capital to come from the owners that should also be mentioned. And name and address of subscribers and the number of equity shares held by each must also be mentioned.

So these are the contents of the Memorandum of Association. In the Articles of Association different rules and procedures for the routine conduct of the company for example, how selection of directors will take place, how often the boards will meet and various other things should be mentioned in the articles of association. So memorandum of association can go up to 5 to 10 pages whereas articles of association can rum to 50 from 50 to 100 pages detailing all the rules and procedures that should guide the routine conduct of the company affairs.

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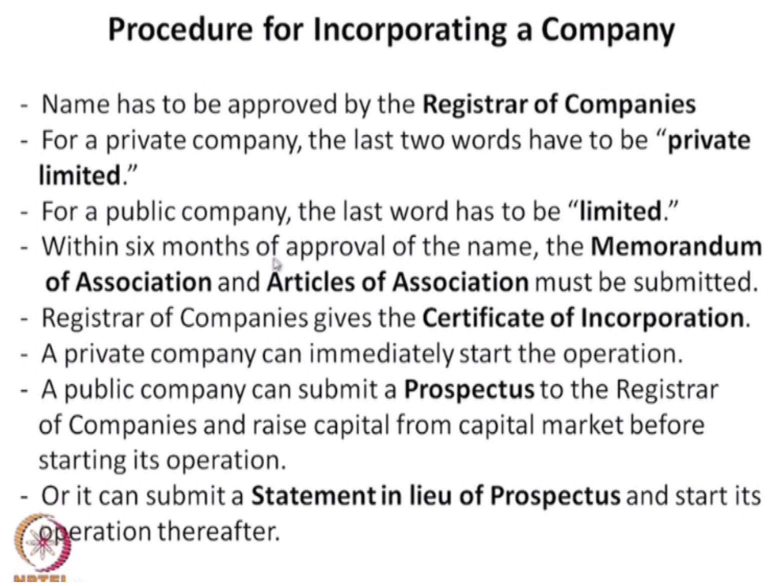

Now for procedure for incorporating a company. First is that the name of the company has to be approved by the Registrar of Companies. If it is a private company, then the last 2 words have to be "private limited" whereas if it is a public company, the last word has to be just "limited." The word "public" is not require to be mentioned. Within six month of approval of the name, the Memorandum of Association and the Articles of Association must be submitted.

Once there are submitted the Registrar of Companies goes through these documents and if they are satisfied then they give it gives the Certificate of Incorporation that means now you can start the business. A private company can immediately start the operation upon receiving the Certificate of Incorporation from t he Registrar of Companies. A public company however as the name indicates has to get money from the public by issuing shares.

So what it has to do, it has to first submit a Prospectus to the Registrar of Companies and raise capital from the capital market before starting its operation. So it has to submit a prospectus about the company to the Registrar and then give publicity to its desire and can issue shares to the public and can raise money or funds from the capital market. Or it can submit also a statement in lieu of Prospectus and start its operation thereafter.

So this is a procedure for starting a company both private and public.

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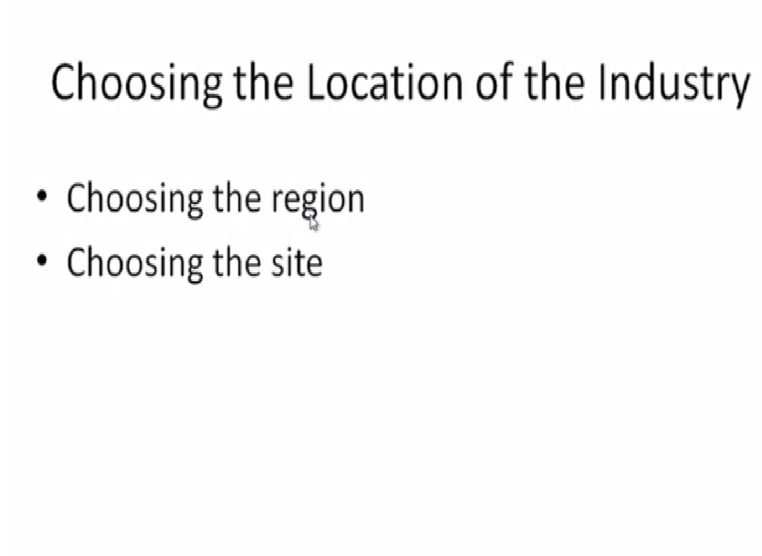

Then of course the location of the industry, we have already discussed about the plant location factors. So naturally considering those factors the region were the new enterprise will be located and exact site where it will be that must be stated in the plan.

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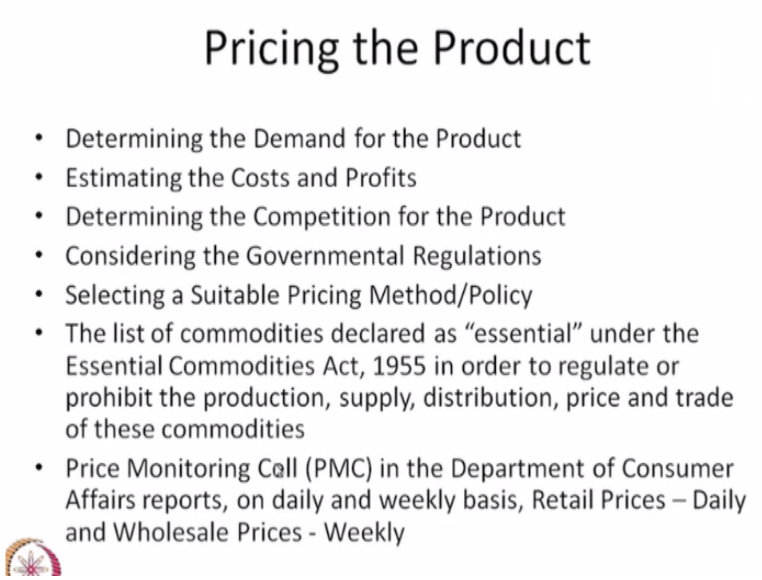

Pricing the Product, we already have discussed lot of things on cost and profits and all other things, so those things have to be considered. One has to first determine the demand of the product, estimate costs and profits, determine the competition, consider the governmental regulations and select a method of pricing. And there are certain essential certain commodities under the Essential Commodities Act which we shall discuss just now where prices, supply, distribution, production and all that are controlled by the government.

So one has to keep it in mind if the product is one of the essential commodities then the government guidelines regarding prices have to be followed then Price Monitoring Cell in the Department of Consumer Affairs reports, on daily and weekly basis, Retail Prices- Daily and Wholesale Prices and also on weekly basis. So this also give an idea towards the pricing, what the prices of the product could be.

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Now as I said there is a list of essential commodities where the government will have the power to produce, supply, distribute and even decide on the price of these items. What are they? In India they are, Cattle fodder, including oil cakes and other concentrates. Coal, coke and other derivatives, parts and accessories of automobiles. Cotton and woolen textiles. Drugs, certain amount of foodstuffs, including edible oilseeds and oils.

Iron and steel, including manufactured products of Iron and Steel. Paper, including newsprint, paperboard and strawboard. Petroleum and petroleum products. Raw cotton, either ginned, un-ginned and cotton seed. Raw Jute. Jute textiles. Fertilizers, whether inorganic, organic or mixed. Yarn made wholly from cotton. Seeds of food crops, fruits and vegetables, cattle fodder, and jute seeds. So these are the essentials commodities whose production, supply, distribution and pricing is rare done by the government.

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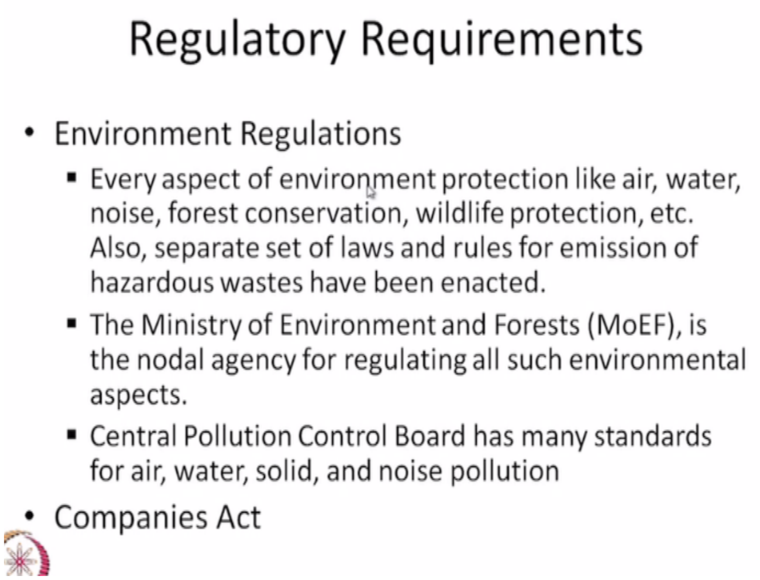

Now there are certain regulatory requirements for every company before it can start. One is the Companies act which we have already discussed. But there are other regulations particularly with regard to environmental protection. Every aspect of environment protection like air, water, noise, forest conservation, wildlife protection, etc are the one here. Also, there are separate set of laws for emission of hazardous wastes.

So the company must ensure that it does not violate any of these provisions, regulatory provisions and get certificate before it can start. Ministry of Environment and Forests is the nodal agency for regulating all such environmental aspects, and this pollution control board in its each state is head office is Central Pollution Control Board but it has offices in different states there called State Pollution Control Board.

They ensure Central Pollution Control Board actually has sets stand for air, water, solid, noise and also hazardous waste pollution. And the State Pollution Control Board ensures that these standards are actually meet by the companies.

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Then, financing a Startup Business, we shall take up this particular aspect of starting a business in our lecture, completely in the next lecture we shall discuss financing. So we are not discussing it here.

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Sourcing of process, raw materials, machinery and equipment. So first of all one have to first decide and select. Then imports are regulated by the Foreign Trade Act, 1992 if they have to be important then one has to go through this exercise. And of course, there are 30 MSME, Micro, Small and Medium Enterprise Development Institutes and 28 Branch MSME Development Institutes formerly they were called SISIs set up in State capitals.

And other industrial cities all over the country who help in deciding or who help in telling what the process requirements are what the raw materials requirements are which machines will be required, which equipment are require to manufacture the products. They have specific guidelines and they can also give help, but the decision as to from which supplier to buy is purely on the manufacture who is deciding to buy them.

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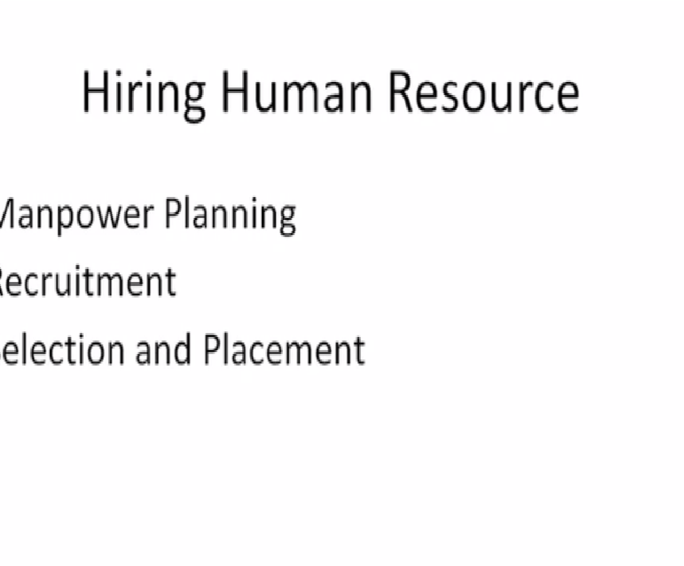

Lastly, hiring human resources and that is very important planning for people, recruiting then, selecting and actually using them. So these are different aspects of a business plan. So before one makes or starts a business he has to make a thorough plan as to how the business will actually function, what product it will make, where from the, where it will be located and different regulatory provisions whether it is meeting, money from where it will come from.

So these are different aspects that are required before it can actually submit the Memorandum of Association and Articles of Association to the Registrar of companies and then it gets Certificate of Incorporation and then if it has sufficient capital it can start the business. If it is a private company, if not it has to submit a prospectus or a statement in lieu of prospectors before it can actually issue shares to the capital market get capital from the capital market and start its business. So these are the procedures and steps required for starting a new company.

Now we see to the next, we go to the next topic which is Small-Scale Industrial Undertakings. Now particularly in India we would like to know what are the different types of small-scale industrial undertakings, how they are defined and these are the things that we would like to study under this topic, so small-scale industrial undertakings.

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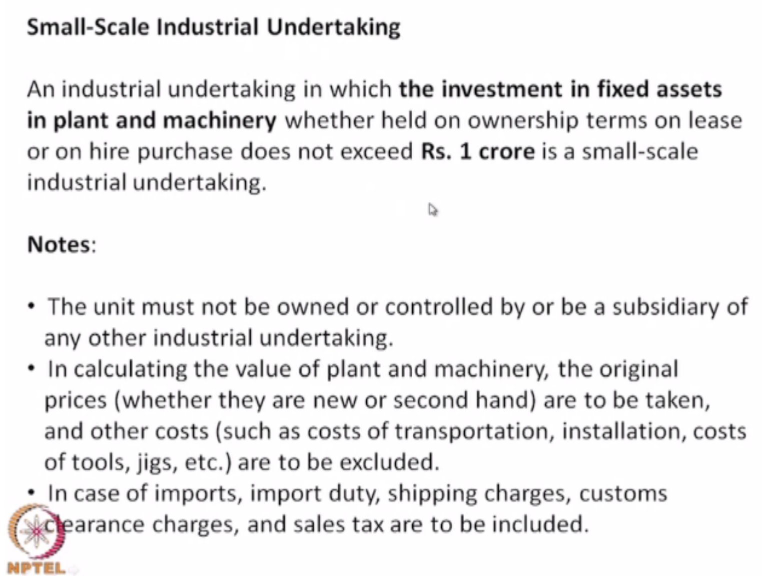

An industrial undertaking in which the investment in fixed assets in plant and machinery whether held on ownership terms on lease or on hire purchase, if it does not exceed Rs. 1 crore then that industrial undertaking is a small-scale industrial undertaking. So basically it says that if the investment in plant and machinery, so these are the keywords investment—so we already know that plant and machinery are the fixed assets.

So investment in plant and machinery if it does not exceed Rs. 1 crore for an industrial undertaking then that industrial undertaking is designated as a small-scale industrial undertaking. Further, these are other things that should be kept in mind. The unit must not be owned or controlled by or be a subsidiary of any other industrial undertaking. So it should not be controlled or owned by some other person or it should a subsidiary of a bigger company.

Then, and also it should have the investment < 1 crore then it is a small-scale industrial undertaking. In calculation the value of plant and machinery, the original prices are to be taken, and other costs such as costs of transportation, installation, costs of tools, jigs they are to be excluded. So the original prices are taken and not the second hand prices. In case of imports, the import duty, shipping charges, customs clearance charges and sales taxes are to be included in the calculation of the investment in the plant and machinery.

So these are certain overwriting rules to define whether an industrial undertaking is small-scale.

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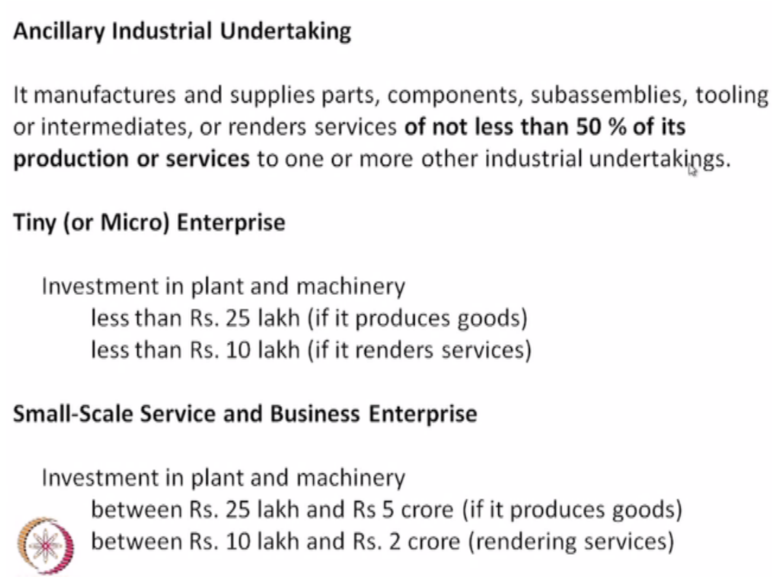

Now, we have Ancillary Industrial Undertaking. An Ancillary Industrial Undertaking manufactures and supplies parts, components, subassemblies, tooling or other intermediates, or renders services of not < 50% of its production or services to one ore other industrial undertakings. That means if an undertaking provides service or supplies parts etcetera to one or more number of industrial undertakings exclusively at least 50% of its total production.

The other the remaining production or services it can sell on its own to various other place things but to specific industrial undertaking if its sells at least 50% of its products or services then it will be called an ancillary industrial undertaking. Then Micro Enterprise or also known as Tiny Enterprise. Here for a, we have already seen that for a small-scale industrial undertaking the investment should be does not exceed 1crore. That means it is < 1crore.

But for a tiny or micro enterprise it should be < only 25lac, if it produces goods and it could be < 10lac if it renders services, it will be then a micro enterprise. Now, another type small-scale industrial undertaking is Small-Scale Service and Business Enterprise. Here the investment in plant and machinery for manufacturing, if it produces goods should be between 25lac and Rs.5crore, then it is called a Small-Scale Service and Business Enterprise.

Or if it is rendering services then its investment in plant and machinery could be between Rs.10lac and Rs.2crore.

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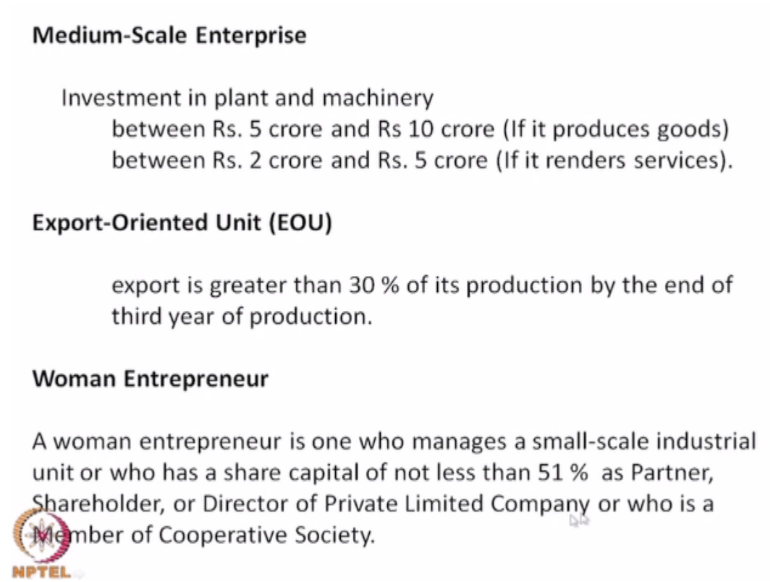

Then also we define Medium-Scale Enterprise. A medium-scale enterprise is defined as an enterprise were the investment in plant and machinery is between Rs. 5 crore and Rs. 10 crore if it produces goods. And it is between Rs. 2 crore and Rs. 5 crore if it renders services. So a medium-scale enterprise is basically the investment is between 5 crore and 10 crore if it produces goods or if is, if it renders services then its investment in plant and machinery should be between Rs. 2 and 5 crore.

Then also we define Export-Oriented Unit. An enterprise is designated as export oriented unit if it exports a minimum of 30% of its production by the end of third year of production. So which means minimum 30% of its production if it exports and that should be achieved by the end of th third-year then it will be designated as an EOU – Export Oriented Unit.

Then a woman entrepreneur is one who manages a small-scale industrial unit or who has a share capital of not < 51% as partner, Shareholder, or Director or Private Limited Company or who is a member of Cooperative Society, such a person is called a women entrepreneur. Make it singular. So a woman entrepreneur is one who manages a small-scale industrial unit or who has a share capital of not < 51% as partner, Shareholder, or Director or Private Limited Company or who is a member of Cooperative Society, 'she' is termed as a woman entrepreneur.

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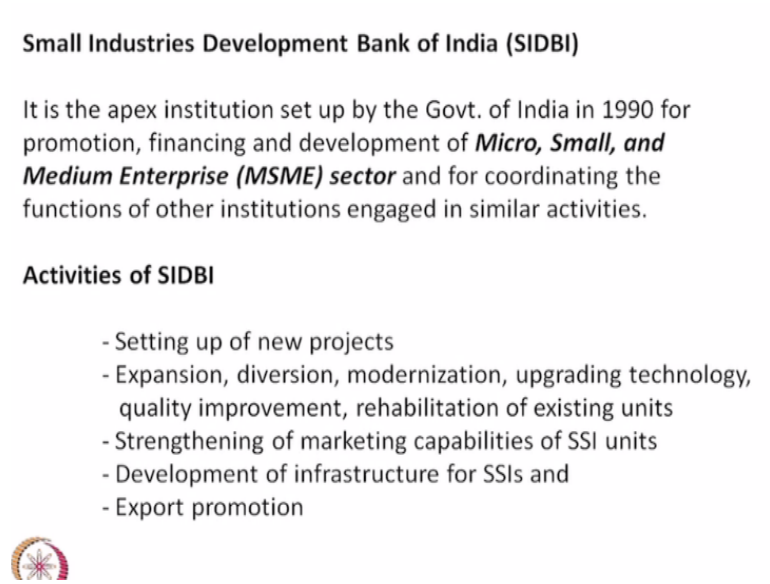

Now, we have SIDBI, Small Industries Development Bank of India setup by the Government of India in the year 1990 for promotion, financing and development of MSME sector, MSME stands for Micro, Small and Medium Enterprise sector and for coordinating the functions of other institutions engaged in similar activities.

So this is the apex institution setup by the Government of India and it can actually fund to start the business, depending on whether you are designated as ancillary industry or a small scale industry or a medium enterprise or a micro enterprise it can help funding the starting of the enterprise. It also as different other activities, the activities of SIDBI the Small Industries Development Bank of India are the following setup of new projects.

It helps you to tell what are the different projects that one can engage in expansion, diversion, modernization, upgrading technology, quality improvement, rehabilitation of existing units this can be these are also done. Strengthening of marketing capabilities of SSI units. Development of infrastructure for SSIs- Small Scale Industry basically SSIs transfers Small Scale Industrial Units, Small Scale Industries, and of course for export promotion. So these are different activities of SIDBI.

Now that we have seen how to start a new company and the different forms of small-scale industrial undertakings and how SIDBI the apex institution setup by the Government of India helps in promoting small-scale enterprises. And because we still have a few minutes left let me start the discussion on how to get capital finance for starting an enterprise and for continuing the activities of a enterprise.

Thus, the next topic which I thought I start in a next lecture I am actually going to start now and that is Capital Financing. Thus, Capital Financing is the topic that it is a new topic I am going to start now and I think I briefly mentioned at the time of discussion on how to start or the steps of starting a new enterprise that there was a slide on capital financing which I did not discussed, I said that we will start in the next lecture but I am going to start it now, right now because we still have about 10 minutes left with us.

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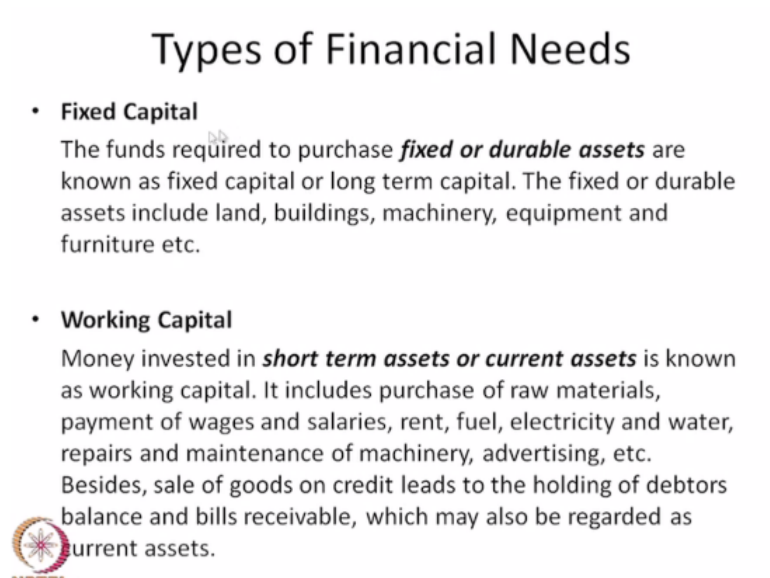

Thus the topic is Capital Financing. Now for an enterprise there are 2 types of financial needs. One the Fixed Capital need and the other Working Capital need. Now what is fixed capital need?

The funds required to purchase fixed or durable assets are known as fixed capital also they are known a long term capital. The fixed or durable assets that require this fixed capital include land, buildings, machinery, equipment and furniture.

All that these items were included in the fixed assets when we discussed the balance sheet. Also in the balance sheet on the asset side we had Current Assets. Now money invested in short term assets also known as current assets is known as working capital. What does it include? It includes purchase of raw materials, payment of wages and salaries, rent, fuel, electricity and water, repair and maintenance of machinery, advertising, etc.

Besides, the accounts receivable that is sale of goods on credit leads to holding of debtor's balance and bills receivable that are also included as current assets in the balance sheet. So these are the 2 principle needs of finance to finance building of the fixed capital, to finance the working capital needs.

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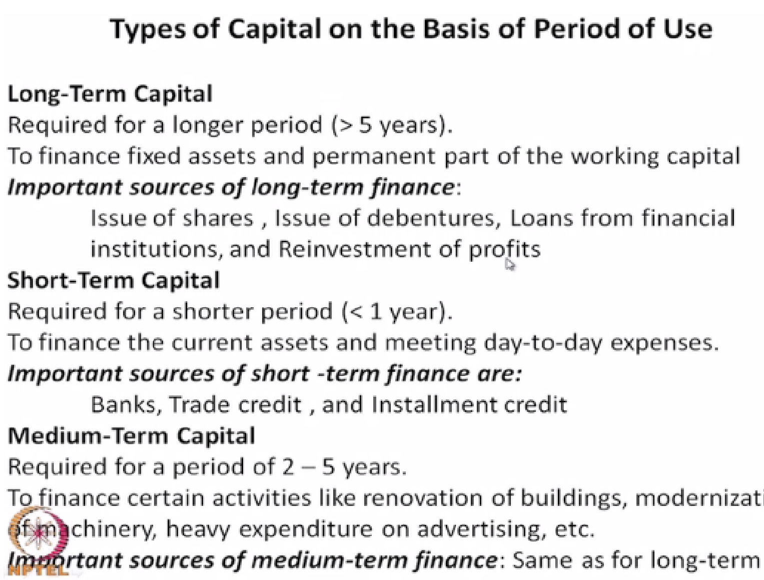

Now depending on the basis of period of fuels also we can divide capital into 3 types, long term capital, short term capital and medium term capital. Long-term capital is required for a period usually > 5 years. And all the fixed assets that we talked about land, building, machinery etcetera they are required for long-term capital, and also in the working capital there may be in need to permanently a permanent part of the working capital is also included in the long-term capital.

The important sources of such long-term capital financing are Issue of shares, Issue of debentures, Loans from financial institutions, and Reinvestment of profits. We shall discuss on each of these issues in our later slides. Short-term capital is usually required for a shorter period between is < 1 year and they are required to finance the current assets and to meet the day-to-day expenses such as wages etcetera.

And the important sources of short-term finance are firstly banks, credit that means pay later or pay in installments. These are the ways to finance short-term capital needs. Now this is < 1 and long-term capital is more than 5 years. So between 2 to 5 years the capital needs are usually called the mid-term capital. They required for such activities like innovation of buildings, modernization of machinery, heavy expenditure on advertising, etc.

And their source of sources of short-term finance, I am sorry this should be medium-term finance. To finance this needs, this is same long-term sources such as shares, debentures, loan from financial institutions or reinvestment of profits.

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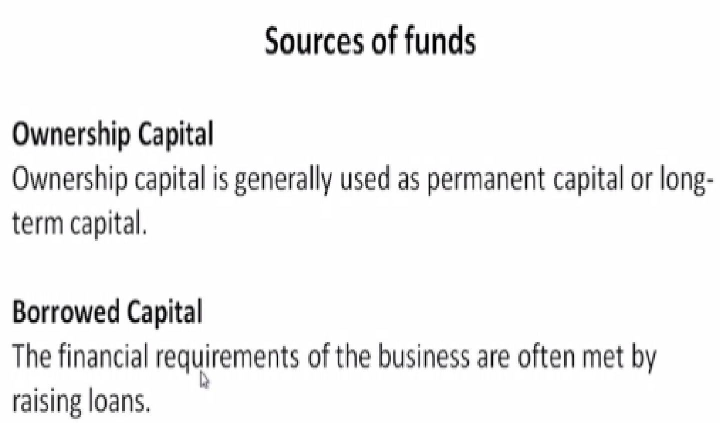

Now there are 2 principle sources of funding the capital needs. One the Ownership Capital, 2 the Borrowed Capital. Ownership Capital means the capital collected from the owners of the company. And usually this used for long-term financing. For permanent capital or long-term capital. The other is borrowed from financial institutions or banks, and that is called borrowed capital. Also they are made by raising loans from public or from financial institutions etcetera.

Now let us sturdy these separately.

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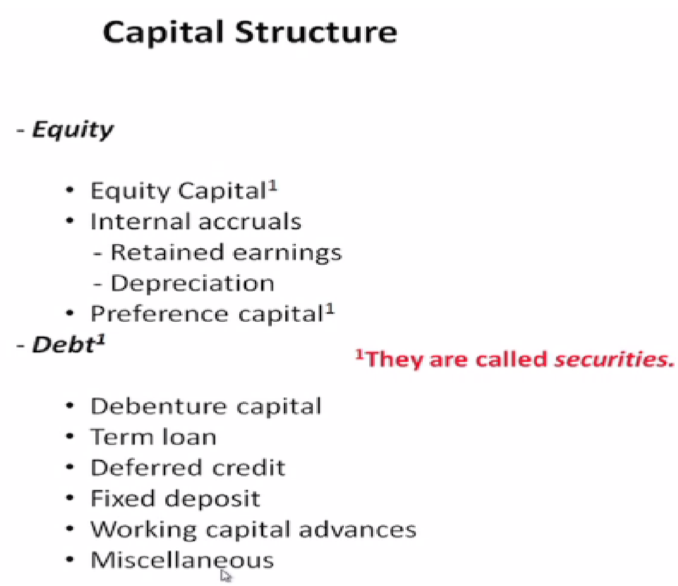

So broadly therefore the ownership capital and the borrowed capital can be grouped separately. The ownership capital is normally called Equity and under equity we have 3 types, one is the Equity Capital so called the common stoke, the preferred stoke and internally generated funds which is the Retained earnings and Depreciation which is a non-cash flow; this we have discussed earlier. So retained earnings + the depreciation they are internally generated funds also known as Internal accruals and also we have capital, equality capital and preference capital.

These constitute the ownership capital. The borrowed capital can be called Debt under Debt we have different forms of debt. Debentures or bond, Term loan, Deferred credit, fixed deposit, Working capital advances, Miscellaneous. Now let us before we go further let us understand that equity capital and preference capital and issue of debentures etcetera they are issued by the company and they are called securities.

So equity shares, preference shares and debentures are called securities, so let me put this one instead of here let me put it here that is more that is correct, not everything coming under dept are securities, it is bond and debentures that are securities.

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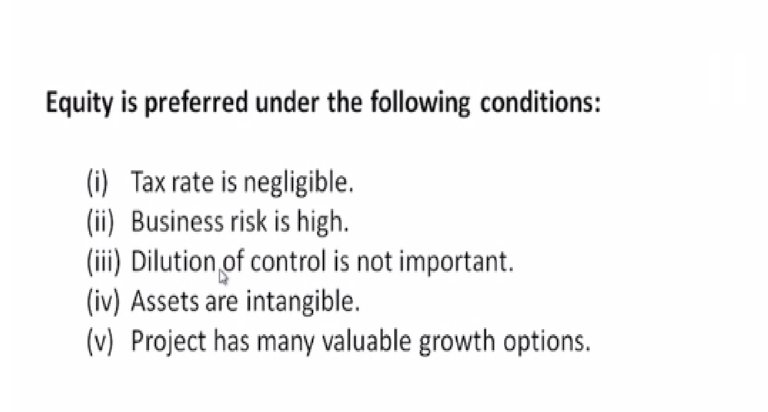

Now under what conditions equity is preferred. Now here the tax rate negligible. The business risk, whenever business risk is high equity financing is preferred. Here as the number of shareholders increases the control is diversified many people are owners therefore control is not restricted. But if such restriction is not very important then equity preference, equity financing is preferred. Also, if financing is required for intangible assets then equity financing is important.

Also if the project for which the equity is required has many valuable growth options. We go for equity financing. So these are the conditions for which equity capital is preferred.

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Public/Private Sources of Capital

Public capital is raised through securities that are

- ***offered*** to the public through an offer document filed through ***Securities Exchange Board of India (SEBI)***
- ***traded*** in public through secondary markets such as *National Stock Exchange (NSE)* and *Bombay Stock Exchange (BSE)*

Private capital is raised through

- loans from bank and financial institutions
- securities privately placed with a small group of investors like private equity funds, venture capital firms, financial institutions, insurance companies, mutual funds, and wealthy individuals.

Now as we know capital can be raised from the capital market from the public or through a or from a small set of private number of people, accordingly they are called public capital or private capital. Public capital is raised through securities that are offered to public through an offer document which is filed through SEBI, SEBI is Securities Exchange Board of India that controls offerings of stocks to the public.

And they are traded in public through secondary markets such as National Stock Exchange and Bombay Stock Exchange, NSE or BSE. So when capital is raised from the public this has to be done through SEBI from the primary market or it can be traded in a secondary market through NSE or BSE. Private capital is raised through loans from banks and financial institutions or by issuing securities to a small group of investors like private equity funds, venture capital firms, financial institutions, insurance companies, mutual funds, and wealthy individuals.

So friends in today's class first of all we gave the various steps and procedures required for starting a company. There we mentioned that raising finance to start a company is a very, very important step and we said that we would start that topic in the next lecture. Then we discussed about various forms of small-scale industrial undertakings, what we found that there are, there is some time left therefore we started the discussion on how to raise finance and the last 10 minutes we discussed about raising finance.

Basically there are 2 principle sources, one is the ownership capital and the other is borrowed capital and slowly we shall discuss the various facets of both the types of capital financing. So in our next lecture we shall discuss thoroughly on different forms of capital financing. Thank you very much.