OLABISI ONABANJO UNIVERSITY

COLLEGE OF ENGINEERING AND ENVIRONMENTAL STUDIES IBOGUN CAMPUS

CREDIT UNIT: 2

COURSE: INTRODUCTION TO ENTREPRENEURAL STUDIES

COURSE CODE: (FEG 403)

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FEG 403: INTRODUCTION TO ENTREPRENEURIAL STUDIES (2 UNITS)

COURSE LECTURERS:

1. Dr. Samuel T.M
2. Engr. Adama O.O.
3. Engr. Lawal N.S. (Coordinator)

PERIOD: 2 Hours per week (Monday 3:00 – 5:00 pm)

MODE OF CLASS: Virtual and Physical

COURSE OUTLINE

1. Definition of entrepreneurship, reasons for study, relevance to engineering graduates, Nigeria and global economy and prevailing situations.
2. Entrepreneurship as root of corporate strategy.
3. Definition of business and scope.
4. Small-scale enterprises.
5. Factors affecting/qualities of entrepreneurship.
6. Sources of finance-short/long term.
7. Finance statement: cash flow.
8. Risk analysis.
9. Business growth: Going concern.

S/No.	Course Lecturer	Assigned Topics
1.	Dr Samuel T.M.	1. Definition of entrepreneurship, reasons for study, relevance to engineering graduates, Nigeria and the global economy and prevailing situations. 2. Entrepreneurship as root of corporate strategy. 3. Risk analysis.
2.	Engr. Adama O.O.	1. Factors affecting/qualities of entrepreneurship. 2. Finance statement: cash flow. 3. Small-scale enterprises.
3.	Engr. Lawal N.S.	1. Definition of business and scope. 2. Sources of finance-short/long term. 3. Business growth: Going concern.
4.	Guest Lecturer	Topic and modalities to be decided by the lecturers.

PART THREE

1. DEFINITION OF BUSINESS AND SCOPE

INTRODUCTION TO BUSINESS

Literally speaking, the term 'business' means to be 'busy' or 'occupied'. In practice, business includes certain economic activities in which people are busy or engaged. Such activities relate to production, distribution, trading or exchange of goods and services to satisfy the needs of people so as to earn income or profit.

Business – Definitions

Business can be defined as the activity of individuals directed towards satisfying human needs at a profit or the economic activities concerned with the production and exchange of goods and services, primarily pursued with the objective of earning profits.

Business – Concept

Every human being is busy in one activity or the other to satisfy his unlimited wants and desires. The sum total of human activities may broadly be divided into two categories- **economic activities and non-economic activities.** Economic activities are designed to attain and use the material resources of life. They are concerned with the production, distribution and consumption of goods and services. Human being as undertake economic activities in order to earn their livelihood.

Business consists of economic activities involving production, purchase and sale of goods and services in order to satisfy the needs of society and to earn profit in the process, Technically the term 'business' is derived from the word 'busy'. This means that someone is busy in earning profit through the process of purchase and sale.

A Good Business Consists of:

a) Creating demand for the products and services before producing and purchasing the goods.
b) Production of the goods and converting the economic resources into goods and services.
c) Continuous research and development in order to improve the quality of goods and services.
d) Activities to ensure that the goods and services not only reach the consumers but also satisfy them in fulfilling their needs.

For instance, a shopkeeper runs his shop, a doctor operates his clinic, a manager works in his office and a lecturer teaches in a college to earn a living for himself/herself and for his/her family. On the other hand, non-economic activities are carried out not for earning money but on account of the human sentiments of charity, love, sympathy, patriotism, religion, etc. For example, a person goes to church to offer his prayers.

CHARACTERISTICS OF BUSINESS

1. **It is a Human Activity:** Business is a human activity which makes available goods and services to the society. It is not only dependent on making available the goods and services or the mere production of these but also depends on the exchange of value which is provided in return because if you are engaged in giving gifts to somebody then it will not be treated as business.
2. **Continuous Economic Activity:** In business an economic activity must be repeated again and again because if an entrepreneur does not do that it will not be treated as business. For example, if a person sells his own house, this activity does not come under the framework of business.
3. **Profit Motive:** Any economic activity which leads to generation of profit is considered as business. Therefore, intension should be to earn profit otherwise if a person is engaged in social service or preaching about the religion cannot be treated as business.
4. **Entrepreneurship:** One cannot run any sort of business without the element of entrepreneurship irrespective of the size of the business. Business can only be run by a daring person who has the ability to face risk of loss. Because no business is there where the element of risk is missing. Involvement of element of risk of loss makes the business world more challenging and to face financial challenge is not everybody's cup of tea.
5. **Creation of Utility:** A man does not produce anything in a way; he only converts the form of resources which are provided by the nature. The business changes the form, place and possession utility of goods and makes them available in usable form. The business creates the utility of the things so that these can be consumed.

Objectives Of Business

A business objective may be defined as the purpose or the reason for the existence of the business in the society. The objective provides the direction towards which all business activities will be directed. Though profit motive constitutes the primary objective of business activities, it should not lead us to conclude that profit is the sole objective of a business. Objectives of a business are multi-dimensional in nature. These objectives are inter-related in nature. They can be classified into four categories, namely:

1. Economic objectives;
2. Social objectives,
3. Human objectives, and
4. National objectives

1. Economic Objectives:

i. **Earning of Profits** – Profits are needed to provide adequate reward to the entrepreneur and to provide funds for future growth. Just as other factors get their rewards, the entrepreneur must get reward for his efforts and taking of risk. Moreover, every businessman will like to see that the business he is managing should grow. This is possible only if the business earns sufficient profits for investing them into the business for expansion.

ii. **Satisfaction of Customers** – The survival of the business depends upon the satisfaction of customers. Thus, the business must aim at winning and satisfying the customers.

iii. **Innovation** – Innovation means developing new technology, new products and their multiple uses. Business cannot succeed without designing new products and finding their new uses.

iv. **Effective Utilisation of Resources** – Business requires the use of men, machines and materials which are considered scarce resources. Every business is expected to make the best possible use of these resources. This objective can be achieved by employing efficient personnel, making full utilisation of machines and reducing wastage of raw materials.

2. Social Objectives: Social objectives of a business denote its obligations towards various stakeholders including customers, employees, community and the government. The important social objectives include the following:

i. **Supply of Quality Goods at Fair Prices** – The business must supply quality products as desired by the customers. The products should be durable, genuine (not duplicate) and safe. The prices charged for the goods should also be reasonable.

ii. **Adoption of Fair Trade Practices** – The business should follow fair business practices at all times. It should avoid anti-social practices like hoarding, black-marketing, over-charging the buyers, etc. It should also not indulge in unfair trade practices like spurious products or misleading advertisements.

iii. **Generation of Employment Opportunities** – Every business should grow and expand its operations to create new jobs for the society. Further, a business should employ suitable people without discrimination based on creed, sex or religion.

iv. **Employees' Welfare** – It is an important responsibility of the business to promote the welfare of its employees. Besides providing fair wages, the business should also provide good working conditions, canteen facility, housing, transport and medical facilities, etc., to the employees.

v. **Community Service** – Modern business organisations engage in community service to fulfil their social responsibility thereby enhancing their public image. Community service may be carried out by running dispensaries and schools, encouraging social activities and setting up training centres for the unemployed youths in the backward areas.

vi. **Protecting the Environment** – Every business should ensure safety of the local surroundings and the protection of the environment. It should take adequate measures to check air, water or noise pollution.

3. Human Objectives: A business is directly linked with two important groups, namely: customers, and employees. Both of these groups must have a feeling of having been treated as human beings by the business enterprise. As human beings, customers expect courteous service and fair dealings from the business.

The employees look forward to the business enterprise for the following objectives:

i. The employees are treated as partners in the business and not as inferior lot; they should get fair wages and healthy working conditions;
ii. They are able to acquire and develop new skills in the process of employment; and
iii. They derive job satisfaction.

4. **National Objectives:** These objectives are concerned with the goals of the nation. Every business enterprise must contribute to the national goals such as:
   i. Achievement of self-sufficiency in production of goods and services,
   ii. Import substitution and export promotion,
   iii. Development of small scale and ancillary industries,
   iv. Development of backward regions,
   v. Economic development of the nation.

SCOPE AND NATURE OF BUSINESS

The scope of business encompasses all human activities, which tend to satisfy needs and wants of the human beings living in a society. A large part of the business is concerned with providing the final or finished products or goods to the desired people. The nature and scope of business are changing very quickly. The people, who are engaged in business, must have to cope with the changing environment because the people's attitudes, habits, testes, likes and dislikes, norms, beliefs, values, perceptions and motives are changing with the change of time. Profit earning cannot be the sole motive of business activity. Businessmen do have a social responsibility too that must be met. Business organizations produce goods and services to generate profit but such activities create impact on society as well as the whole community. The responsibility of businessman is to provide the goods and services in a way which is not harmful to the society.

Types of Stakeholders Involved in a Business:

Five types of stakeholders are involved in a business:

i. Owners
ii. Creditors
iii. Employees
iv. Suppliers
v. Customers

Each type of stakeholder plays a critical role for firms, as explained below:

i. Owners:

Every business begins as a result of ideas about a product or service by one or more entrepreneurs. As entrepreneurship is the act of creating, organizing, and managing a business. Entrepreneurs are critical to the development of new business because they create new products (or improve existing products) desired by consumers.

ii. **Creditors:**

When a firm is initially created, it incurs expenses before it sells a single product or service. For example, it may have to buy machinery, rent a facility, and hire employees before it has any revenue. In the first several months, its expenses may exceed its revenue even if it is well managed. Therefore, the firm cannot rely on cash from sales to cover its expenses. The owners of a new business may initially have to rely on friends or family members for credit because their business does not have a history that proves it is likely to be successful and therefore able to pay off its credit in a timely manner.

iii. **Employees:**

Firms hire employees to conduct their business operations. Some firms have only a few employees; others, such as General Motors and IBM, have more than 200,000 employees. Many firms attribute their success to their employees.

iv. **Suppliers:**

Firms commonly use materials to produce their products. For example, automobile manufacturers use steel to make automobiles, while home builders need cement, wood siding, and many other materials. Firms cannot complete the production process if they cannot obtain the materials. Therefore, their performance is partially dependent on the ability of their suppliers to deliver the materials on schedule.

v. **Customers:**

Firms cannot survive without customers. To attract customers, a firm must provide a desired product or service at a reasonable price. It must also ensure that the products or services produced are of adequate quality so that customers are satisfied. If a firm cannot provide a product or service at the quality and price that customer's desire, customers will switch to the firm's competitors.

Assessment of the Business Environment:

The business environment surrounding the business includes the economic environment, the industry environment, and the global environment.

1. **Economic Environment:** The economic environment is assessed to determine how demand for the product may change in response to future economic conditions. The demand for a product can be highly sensitive to the strength of the economy. Therefore, the feasibility of a new business may be influenced by the economic environment.
2. **Industry Environment:** The industry environment is assessed to determine the degree of competition. If a market for a specific product is served by only one or a few firms, a new firm may be able to capture a significant portion of the market. One must also ask whether a similar product could be produced and sold at a lower price, while still providing reasonable earnings.

3. **Global Environment**: The global environment is assessed to determine how the demand for the product may change in response to future global conditions. The global demand for a product can be highly sensitive to changes in foreign economies, the number of foreign competitors, exchange rates, and international trade regulations.

2. SOURCES OF FINANCE

Sources of funds may be grouped into three categories:

1. **Long-term financial requirements,** which are for a period exceeding five to ten years. All funds to be invested in various types of fixed assets plus in hard core working capital are to be considered as long-term financial needs.
2. **Medium-term financial requirements** which are required for a period exceeding one year but not exceeding five years. All funds needed for meeting the defined revenue expenditures such as: expenses on heavy publicity and advertisement campaigns shall be considered as medium-term financial needs.
3. **Short-term financial requirements** which arise for a short period of time often not exceeding one year (i.e., accounting period). All funds needed for financing current assets/for meeting working capital requirements shall be considered as short-term financial needs.

A. Long Term Sources of Finance

The long term sources of finance are shown below:

1. Equity Share Capital: Equity shares, also known as ordinary shares or common shares represent the owners' capital in a company. The holders of these shares are the real owners of the company. They have control over the working of the company. The rate of dividend on these shares depends upon the profits of the company. They may be paid a higher rate of dividend if the profit of the company is high or they may not get anything if the profit of the company is not sufficient. Equity shareholders are paid dividend after paying dividend to the preference shareholders.

2. Preference Shares: A preference share is a share which carries preferential rights as to the payment of dividend at a fixed rate either free or subject to income tax and as to the payment of capital at the time of liquidation prior to equity shareholders. In simple words we can say that preference shares have certain preferences as compared to other types of shares.

These preferences are given below:

i. The first preference is for payment of dividend.
ii. The second preference for these shares is the repayment of capital at the time of liquidation of the company.

A company can issue preference shares of varying dividend rates at a time viz. 10% Preference Shares, 12% Preference Shares etc. these % are showing the fixed rate of dividend which is payable to the preference shareholders

3. Debenture: Debenture includes debenture stock, bonds or any other securities of a company whether constituting a charge on the assets of the company or not. A debenture holder is a creditor of the company. A fixed rate of interest is paid on debentures. The interest due on debentures is a charge on the profit and loss account of the company. The debentures are generally given a floating charge over the assets of the company.

4. Loans from Financial Institutions: This is also termed as 'Term Loan'. Term loans refer to the borrowed capital of the companies, repayable in not less than one year and normally not more than ten years. Financial institutions provide this type of loan. This source of finance is more suitable to meet the medium-term demands of working capital.

Features of Term Loan:

i) The loan is given for a specific purpose or a particular project.

ii) All term loans have a first charge on the assets for which the loan is sanctioned.

iii) Rate of interest charged by the financial institutions may differ from project to project.

iv) In case of bigger projects one financial institute may not provide for full requirement of the project. A group of different institutions may be constituted to collectively sanction a term loan for the project.

5. Ploughing Back of Profits/Retained Earnings: A company generally doesn't distribute all its earnings amongst the shareholders as dividend. A portion of the net earnings may be retained in the business for use in the future. This is known as retained earnings. It is a source of internal financing or self-financing or ploughing back of profits. The profit available for ploughing back in an organization depends on many factors like net profit, dividend policy, and age of the organization etc. It means the reinvestments by concern of its surplus earnings in its business.

Advantages of Retained Earnings:

The followings are the advantages of retained earnings:

i) Retained earnings are a permanent source of funds available to an organization.

ii) It enhances the capacity of the business to absorb unexpected losses.

iii) It may lead to increase in the market price of the equity share of the company.

iv) As the funds are generated internally, there is a greater degree of operational freedom and flexibility.

v) It doesn't involve any explicit cost in the form of interest, dividend or floatation cost. Hence it is the cheapest source of finance.

vi) By raising the funds with retained earnings, there will be no dilution of control.

Disadvantages of Retained Earnings:

There are several advantages associated with the retained earning but there are some disadvantages of the same. The followings are some of them:

i) Excessive ploughing back may cause dissatisfaction amongst the shareholders as they would get lower dividends.

ii) It is an uncertain source of funds as the profits of business are fluctuating.

iii) The opportunity cost associated with these funds is not recognized by many firms. This may lead to suboptimal use of the funds.

3. Term Loans

A term loan is a monetary loan that is repaid in regular payment over a set period of time. Term loan usually lasts between one and ten years but may last as long as 30 years in some cases. It usually involves an unfixed interest rate that will add additional balance to be paid. They are the sources of long term debt for financing large expansions, diversification of projects etc., they are also referred as Project Financing.

Advantages of Term Loans:

Term Loans are beneficial for the borrower as well as for the lender, as is clear from the following:

A) Advantages to Borrowers:

Borrowers have following advantages, if they choose for term loans rather than going for some other source:

i) From taxation point of view, raising finance through term loan is cheaper than those raised through equity capital or preference capital.

ii) Borrowing companies do not lose control over their management, as the lenders do not have rights to vote.

B) Advantages to Lenders:

Lenders find term loans very convenient and profitable because of the following advantages:

i) The first advantage of lender's in term loans is getting a fixed rate of interest and a certain maturity period.

ii) They are fully secured with the borrower's assets (primary as well as collateral securities).

iii) Interest of lending institutions is protected by many restrictive clauses imposed on the borrowers.

Disadvantages of Term Loans:

Borrowers as well as lenders have following disadvantages in raising and lending term loans respectively:

A) Disadvantages to Borrowers:

The disadvantages of term loans from the borrowers view point are as follows:

i) Periodical repayment of instalments representing interest and principal are obligatory in nature. Failure to fulfil the obligation may invite imposition of penalty from the lender in the form of liquidated damages.

ii) In terms of the contract relating to term loan, a lender has the right to appoint its nominees on the Board of a borrower. Managerial freedom of the borrower is thus compromised to a great extent. In addition to the above, there are other clauses also, which are not in favor of the borrower.

iii) Financial risk of the borrower increases many times after availing a term loan. This results in the increased cost of equity capital.

B) Disadvantages to Lenders:

The lenders are at a disadvantageous position in respect of following:

i) Although a lender can appoint its nominee on the borrowing company Board, no voting rights are available for him.

The securities equitable-mortgaged in favour of the lender are not negotiable. This problem, however, may be sorted out by the process of securitization.

3. Lease Financing

Initially, the concept of lease was limited to land only but for the past few years, lease financing is becoming operational in the industrial arena. Lease is a long-term source of business finance. Companies can take necessary business assets on lease rather than buying them.

If they purchase these fixed assets, they have to pay in full. Contrarily, under lease agreement the company gets the right to use the asset after making part payment for it. Under this arrangement, the owner of the asset (lessor) surrenders the right to use the asset in favour of another person (lessee) in consideration of predetermined rent.

After the lease period, whether the asset will be returned to the lessor or it will be retained by the lessee, depends on the terms of lease. Thus, the ownership and the use of assets, in case of lease, lie in different hands. In the industrial era, the use of lease financing started after 1980.

During this period, the financial needs of the industrial units also increased due to the rise in price level. Ranks and other financial institutions were unable to meet these requirements. Banks were overburdened with the credit to the priority sector.

With effect from 1987-88, the Government withdrew the investment allowance, which made the acquisition of equipment on lease to be more useful rather than purchasing them.

B. Short Term Sources of Finance

Sources of finance are the most explored area for the businessmen, a boost to start a new business. There are several sources of finance, i.e., Equity Share Capital, Preference Share Capital and Debentures, etc. These are long-term sources of finance. Purpose of this finance is to finance fixed assets, construction projects on large scale, expansion of companies, etc. but business firms need to manage cash for operations, such as activities involved in the day-to-day functions of the business conducted for the purpose of generating profits. For recurring activities, short-term finance also plays an important role. Time period of short-term finance is not exceeding one year. Basically it is related to the working capital requirement of the company.

The following are the short-term sources of finance:

(1) Trade Credit

(2) Accrued Expenses

(3) Advance from Customers

(4) Commercial Paper

(5) Factoring

(6) Leasing

The short-term sources of finance can be divided into two parts:

A. Bank Sources:

The bank sources of short term finance include:

(i) Line of Credit: Under this source, the bank determines the maximum limit of credit for the customer. Customers can withdraw money from the bank within this limit. The maximum amount of credit is determined on the basis of goodwill of the customer, his size of business, financial position and allied factors. Interest has to be paid on the amount actually withdrawn.

(ii) Overdraft: In this facility, the bank allows the customer to withdraw more than his actual deposit in his current account. The excess amount withdrawn is called overdraft. The amount of overdraft is also determined on the basis of financial position of business.

The quantum of overdraft is generally less than the line of credit. Bank honours the cheques of customers within a predetermined time frame. Interest is charged on the actual amount withdrawn.

(iii) Secured Loan: Banks generally grant credit on the basis of security of the current assets like inventory. The assets held as security remain in control of the bank. As soon as a loan is paid by a customer, he is allowed to have control of his goods. Under this source, banks grant loans after reserving a fair margin. The amount of loan is transferred to the account of the customer. Interest is charged on the whole amount of loan rather than the actual amount withdrawn.

(iv) Discounting of Bills: Customers can discount the bills due on the future date from the bank. The amount of the bill after charging a discount is transferred to the account of the customer. On the date of maturity, the branch collects money from the drawee of the bill.

(v) Letter of Credit: It is another form of credit purchase. In the letter of credit, the bank takes the guarantee of payment which is supposed to be paid by the buyers of the goods. In case of default, the bank is responsible for making these payments.

B. Non-Banking Sources:

The non-bank sources of short term finance are:

(i) Public Deposits: Public deposits for a period of one year are a short term source of finance. The public deposits for more than one year are included in medium term sources of finance.

(ii) Short-Term Loans: Short term loans, secured or unsecured can be taken from other parties accepting banks including merchant bankers, finance companies, co-operative societies, relatives, etc.

(iii) Trade Credit: Trade credit is the credit extended by one trader to another for purchasing goods and services. Credit period starts on the receipt of goods and extends till the payment is made therefore. When the goods are delivered, the minimum time for this exercise is 30 days, 60 days and 90 days, but in jewellery business it is extended to 180 days.

Features:

(1) It is an internal arrangement between the buyer and seller.

(2) It is a self-generated source of financing.

(3) There are no formal legal instruments of debt.

(4) It is an expensive source of finance if payment is not made within the discount period.

Advantages of Trade Credit:

(1) It is easily accessible.

(2) It does not require any period of negotiation or formal agreement.

(3) It reduces the owner's capital and borrowed capital.

(4) There is no need of creating any sort of charge against the firm's assets for obtaining the trade credit.

Disadvantages of Trade Credit:

(1) It is very expensive, if payment is not made on maturity date.

(2) Trade credit is available only to those companies who have a good trade record of repayment in the past.

(3) If re-payments are not made within the time limit, the business will receive poor credibility, therefore, no loans, trade credit, leasing given to business in near future.

(4) If payments are not made within the prescribed period of Trade Credit, it will negatively affect working capital. It will spoil the relationship with the other business which will increase the cost of capital.

(iv) Promissory Notes and Hundies: Under it, the buyer gives hundi or promissory note after purchasing the goods. On due date, payment is received from him.

(v) Advance from Customers: This is the very cheapest source of finance, price of goods to be purchased are paid in advance before the receipt of a goods. It is really useful in those businesses where costly goods are to be produced. Long production cycles, like special types of machine manufacturing industrial products prefer to take advance from their customers.

The seller might require advance because the quantity of goods ordered is so large and cannot afford to tie up more funds in purchasing of raw material or work in progress. Goods are actually delivered after some time. No interest is paid on this advance.

(vi) Accrued Expenses: Accrued expenses are expenses which have been incurred but not yet paid. Accrued accounts become an important source of finance since with the increase in scope of the operation of the business along with increase in sales and costs. Usually with them, the amount of accrued wages also increases. To support this, we take an example.

Wages are paid in the first week of the month next to the month in which the services were rendered. Another example is a provision for tax is created out of the profits of the company at the end of the financial year but tax is paid only after the assessment is finalised. Ultimately, time log between receipt of income and making for expenditure incurred increasing that income helps the business in meeting short-term financial requirements.

Some Examples of Accrued Expenses:

(vii) Provision and Reserves: Provision may be made in the books, against some future liability like tax and bad debt provision, when the amount is not certain. From profit after tax, various future expenses are deducted as estimated expenses of the future like reserves for proposed dividends and for proposed bonus. As these provisions and reserves are not immediate cash outflows, they provide cash to the firm for its current use. However, the firm is supposed to make payments of these provisions and reserves when they become due.

(viii) Commercial Paper: Commercial paper represents a short-term unsecured promissory note issued by firms that have a fairly high credit rating. It was first introduced in USA and it is an important money market instrument. They are issued in large denominations (minimum amount is Rs.0.5 million) in the market through banks or merchant bankers.

Commercial papers are usually issued to finance seasonal needs for funds. It is very popular in developed countries like USA, UK and France. In India, commercial papers were introduced on the suggestion of the working group on the money market in 1987.

Advantages of Commercial Papers:

(1) The Cost of commercial papers is lower than the commercial bank loans.

(2) Commercial papers can be issued only when the money market is tight.

Disadvantages of Commercial Papers:

(1) Commercial paper can neither be redeemed before maturity date nor can be beyond maturity date.

(2) New and moderately rated firms are not issuing commercial papers but large firms who enjoy high credit rating and sound financial position.

(ix) Factoring: In factoring, accounts receivables are generally sold to a financial institution (a subsidiary of commercial bank called “Factor”), who charges commission and bears the credit risks associated with the accounts receivables purchased by it. Factoring as a means of financing is comparatively costly source of finance. The cost of factoring is higher than normal lending rates.

Advantages of Factoring:

(1) Factoring ensures a predetermined pattern by cash inflows.

(2) Due to continuous factoring, there is no need for credit department.

(3) Any business organisations can convert accounts receivables into cash without bothering repayment.

(4) Factorising business is required to be fulfilled under the supervision of RBI guidelines.

(x) Forfeiting: A form of financing of receivables arising from international trade is known as forfeiting. Within this arrangement, a bank/financial institution undertakes the purchase of trade bills/promissory notes without recourse to the seller. Purchase is made through discounting of the documents covering the entire risk of non-payment at the time of collection. All risks become the full responsibility of the purchaser (forfeiture). Unlike factoring, which is firm based, forfeiting is transaction based. Through this exporters are able to avert risk for non-settlement of claims as it provides for a non-recourse facility. Moreover, exporters need not to assume any botheration of credit administration and collection problems.

3. BUSINESS GROWTH

MEANING OF BUSINESS GROWTH

Business growth is a natural process of adaptation and development that occurs under favourable conditions. The growth of a business firm is similar to that of a human being who passes through the stages of infancy, childhood, adulthood and maturity. Many business firms started small and have become big through continuous growth. However, business growth is not a homogeneous process. The rate and pattern of growth varies from firm to firm. Some firms grow at a fast rate while others grow slowly. Also, not all enterprises survive to grow big. This may be due either to the nature of the firm or the entrepreneur. Some entrepreneurs do not want to grow their ventures, choosing instead to pursue other interest, spend more time with family or develop other business activities.

The Concept of Business Growth

Generally, the term **'business growth'** is used to refer to various things such as increase in the total sales volume per annum, an increase in the production capacity, increase in employment, an increase in production volume, an increase in the use of raw material and power. These factors indicate growth but do not provide a specific meaning of growth. ***Simply stated, business growth means an increase in the size or scale of operations of a firm usually accompanied by increase in its resources and output.***

Need for Business Growth

As we have already said that business enterprise is like a human being, growth is a necessary stimulant to most of the business firms. As a matter of fact, growth is precondition for the survival of a business firm. An enterprise that does not grow may, in course of time have to be closed down because of its obsolete products. The market is full of examples of very popular products disappearing from the scene for lack of growth plans. For example, pagers vanished from the market because better technology product i.e. cell phones were introduced. The reasons which drive business enterprises toward growth are described below:

i. **Survival:** In a competitive market no single enterprise can have monopoly. The competition can be direct or indirect. Direct competition comes from other firms manufacturing the same product. Indirect competition may come from availability of cheaper substitutes. Severe competition forces a firm to grow and gain competitive strength. Any business firm that fails to grow can't survive for long. A growing concern will be an innovator and can easily face the risk of competition. Thus growth is means of survival in a competitive and challenging environment.

ii. **Economies of Scale:** Growth of a firm may provide several economies in production, purchasing, marketing, finance, management etc. A growing firm enjoys the advantages of bulk purchase of materials, increased bargaining power, spreading of overheads, expert management etc. This leads to low cost of production and higher margin of profit. This also ensures full utilization of plant capacity.

iii. **Owners Mandate:** The owners of a company get the ultimate benefit of growth in the form of higher profits. They may direct the management to reinvest a substantial portion of the earnings in the business rather than paying them out. Capable management may on its own like to take carefully calculated risk and expand the size of the company.

iv. **Expansion of the Market:** Increase in demand for goods and services leads business firms to increase the supply also. Population explosion and transportation led to increase in the size of markets which in turn resulted in mass production. Business firms grow to meet the increasing demand. Expanding markets provide opportunity for business growth.

v. **Latest Technology:** Some business firms invest in research and development activities to create new products and new techniques, while others try to acquire latest technology from the market. Rationalization and automation results in more efficient use of resources and a firm may grow to obtain them.

vi. **Prestige and Power:** The more the size of the business firm increase the more is the prestige and power of the firm. Businessmen satisfy their urge for power by increasing the size of their business firm.

vii. **Government Policies:** A big firm is in a better position to carry out the various legal formalities required to obtain licenses and quotas. Business firms may plan for growth to make use of the incentives provided by the government. The government provides certain subsidies and tax concessions to the new industrial units in the backward areas and those producing goods for export only.

viii. **Self-sufficiency:** Some firms grow to become self-sufficient in terms of marketing of raw material or marketing of products. Growth in either or both of these forms reduces the dependency of the firm over other firms.

Advantages of Business Growth

Business firms try to achieve growth in order to obtain the following advantages:

1. Obtaining the economies of scale.
2. Exploitation of business opportunities.
3. Facing competition in the market by diversifying the product line.
4. Providing protection against adverse business conditions eg. Depression.
5. Gaining economic and market power.
6. Raising profits and creating resources for further reinvestment into business.
7. Making optimum utilization of resources.
8. Securing subsidies, tax concessions and other incentives offered by the government.

Limitations of Business Growth

Business firms cannot grow indefinitely. Business growth has its own limitations which are:

1. **Finance:** Growth, especially external growth, requires additional capital investment which is sometimes difficult for a small firm to arrange.
2. **Market:** Growth can be achieved to the extent that the size of market permits. If a firm grows faster than increase in the size of the market, it is likely to face failure.
3. **Human Relations Problems:** In a big firm, management loses personal touch with employees and customers. Motivation and morale tend to be low resulting in inefficiency.
4. **Management:** Growth increases the functions and complexities of operations. As the number of functions and departments increase, coordination and control become very difficult. If the organization and management structure is not capable of accommodating them, growth may be harmful.
5. **Lack of knowledge:** Under conglomerate growth, a firm enters new industries and new markets about which the managers know little. Managers find it difficult to find and develop managers who can quickly handle new units and improve their earning potential against heavy odds. Many growing firms could not succeed because their managers felt that they could manage anything anywhere.
6. **Social problems:** From social point of view also big firms may be undesirable as they may lead to concentration of economic power and creation of monopolies which may exploit consumers. In their desire for growth firms indulge in combative advertising. The quickening growth creates a cultural gap when society finds it difficult to cope with technological change.

Forms of Business Growth

Once an entrepreneur understands some of the factors that influence growth and development, he can choose a suitable way for achieving it. Business growth can take place in many ways. Broadly, various types of growth can be divided into two broad categories — organic and inorganic growth.

A. **Organic Growth** — It can also be termed as internal growth. It is growth from within. It is planned and slow increase in the size and resources of the firm. A firm can grow internally by ploughing back of its profits into the business every year. This leads to the growth of production and sales turnover of the business. Internal growth may take place either through increase in the sales of existing products or by adding new products. Internal growth is slow and involves comparatively little change in the existing organization structure. It can be planned and managed easily as it is slow. The ways used by the management for internal growth include:
    i. Intensification,
    ii. Diversification,
    iii. Modernization.

B. **Inorganic Growth** — it can also be termed as external growth. It involves a merger of two or more business firms. A firm may acquire another firm or firms may combine together to improve their competitive strength. External growth has been attempted by the business houses through the two strategies (a) mergers and acquisitions and (b) joint ventures. Merger again can be of two types:

i. Firms merge with other firms in the same industry having similar or related products. This type of merger leads to coordination problem between the two firms.
ii. Firms merge with another firm in altogether different lines of business and have little common in their products or processes such a merger is known as conglomerate merger.

Inorganic growth is fast and allows immediate utilization of acquired assets. There is no risk of overproduction as the capacity of the industry as whole remains unchanged. Merger leads to combination of independent units to control competition, to gain economics of scale and also sometimes, to modernize production facilities. But merger also leads to social problem of monopoly, problem of coordination, strain on capital structure, etc. Thus, external growth involves problem of reorganization.