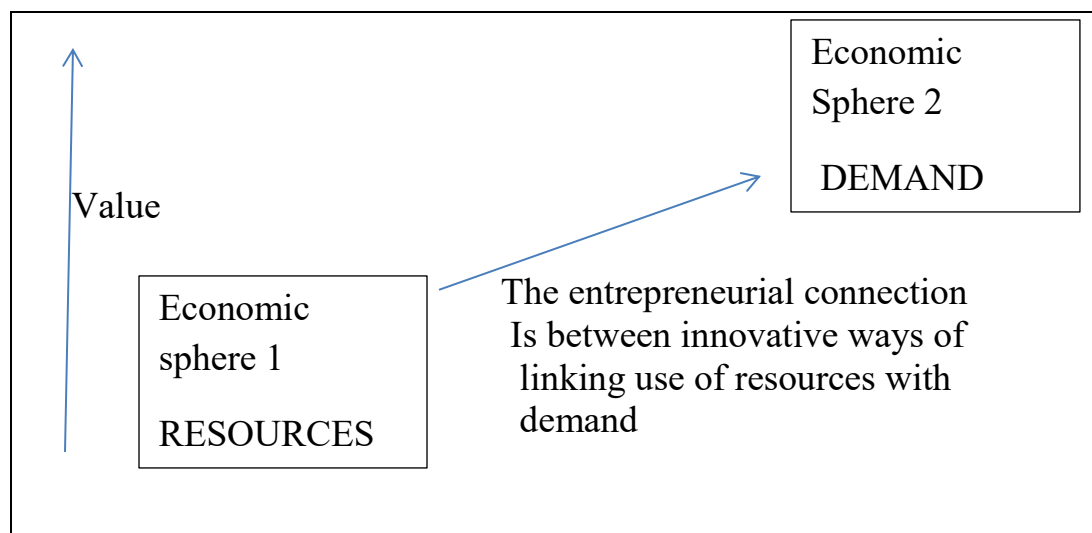


#### 1.4. Entrepreneurship

1.4.1. Entrepreneurship is livelihood generation by an individual through own resources and labour. It is also called small scale entrepreneurship. Historically, 'Entrepreneur' is a French word meaning 'one who manufactures or trades alone, with small capital to earn a living.' The term was meant to define the new profession of an individual manufacturer who emerged after the French Revolution. It distinguished this new livelihood, from the earlier professions of a cultivator or farmer, or the soldier.

1.4.2. Entrepreneurship seeks to bridge an existing gap in demand and supply. It fulfills the special needs in one economic area by arranging for supplies from another economic activity. In this exchange profit is the excess in the value traded and the resources utilized.

##### A model of the entrepreneurial connection



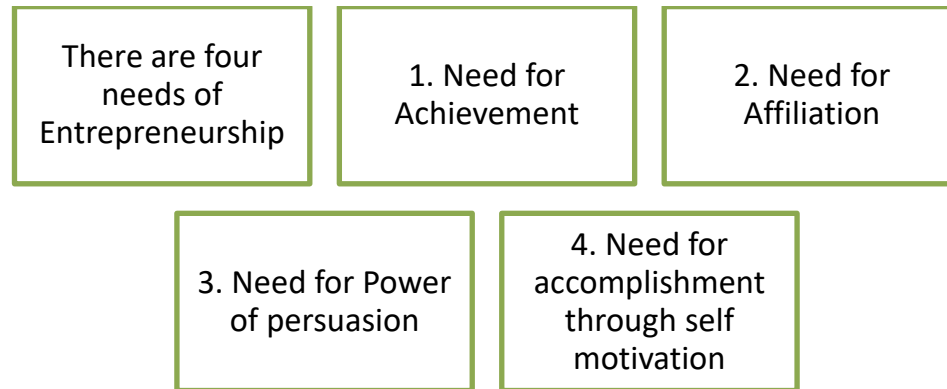
1.4.3. An entrepreneurship or small manufacturing is characterised on basis of small amount of finance or capital invested, fewer number of workers

employed, the total number of customers for the products. It is indicative of a situation in which capital is scarce, but labour available is in plenty.

#### 1.4.4. Entrepreneurial Objectives:

- a) For success it is important that the entrepreneur concentrates on the business, instead of trying several enterprises simultaneously.
- b) Profit is the most relevant goal variable and objective.
- c) Measurability of profits: Market prices as an evaluation of output and input, is a clear and meaningful concept to an entrepreneur.
- d) It is also a practical and useful goal variable for economic research on equities on the stock market.
- e) Profits measured as ratio of Input and Output, are to be additionally measured as 'the increase in aggregate consumption. (Aggregate consumption benefits): (Aggregate consumption costs). These should also be measured in terms of shadow prices.
- f) Factors that directly influence the profits of a firm should be researched upon regularly. Their trends in the market should be observed to increase the product prices and keep the firm profitable.
- g) This can be done by a simple method of analysis where clusters of firms are compared for differences and similarities within and between them.

#### 1.4.5. Concepts of entrepreneurship



1.4.17. **Power is the probability of one to carry out her or his own will despite resistance.** Threat of conflict and Payoff of a conflict can be linked to concepts of power and dependence.

1.4.18. **Sources of Power for an entrepreneur** include the following:

- a) Customer preference.
- b) Completeness of line of goods and services.
- c) Financial and business advice.
- d) Sharing advertising expenditure.
- e) Product sales meetings.
- f) Service schools.
- g) Salespersons' / employees training and skill development.
- h) Image and reputation in the community.
- i) Prompt delivery and after sale service.
- j) Access to market information.
- k) Selective distribution.
- l) Promotion programme.
- m) Large lot buying.
- n) Ability to buy directly.
- o) Ability to control customer's brand choice.
- p) Brand support by intermediary.
- q) Competitive pricing.

1.4.4 **Persuasion** is a form of communication which directly aims at a change in attitude or behaviour of one of the two parties. In

Bargaining Power No. 1 and 4 are used out of the four models of persuasion:

1. The Rhetorical Model of Aristotle has three modes of character, emotion and proof. Strong characters are able to persuade through emotions as well as example of their own public behaviour .

2. Propagandist Model is based on atmospherics created by looks and appearance, event management as in exhibitions, and partly rhetorics.

3. Negotiation model : seeks to win the best terms for both parties. It is often based on threats and inducements.

4. Communication model: Distinguishes between communicator (Who?) , Message (What) , Channel (How?) and Audience ( To whom)

1.4.6. A Communication model of the sales process based on Persuasion:

1. Impression formation	2. Strategy formulation	3. Transmission	4. Evaluation
1.1 Develop an impression of the customer	2.1 Select a strategic objective and formulate messages	3.1 Deliver message	4.1 Assess the effect of the message
1.2 Modify impression	2.2. Change objective and / or formulation	3.2 After communication modify and change the style if not good.	4.2. Is it Good? 4.3 If yes, Realize Objective

1.4.7. **Game Theory:** Negotiation can be described by Game Theory.

1. Most models use cardinal utility as a measure of payoff.

2. This introduces ambiguity as to what dimensions should be considered and how?

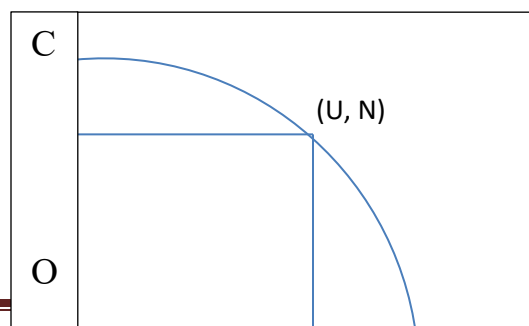
Is there a linear relation between money and utility?

How does this relation vary?

3. When Bargaining uses persuasion in a utility – transfer context, it becomes a means for seeking the Pareto optimal contract.

1.4.8. **Pareto Optimality** is achieved with utility is maximised for 1, given the utilities of others, and none can increase utility without causing deterioration of others.

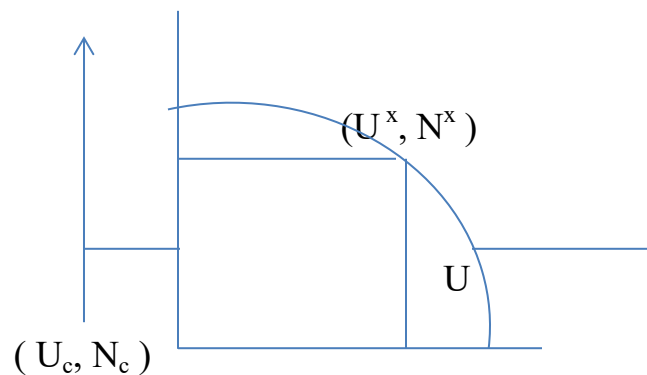
- a) Successful Bargaining will be along the contract curve C-C' in the graph shown below.
- b) The Nash model of bargaining assumes that the set of possible contracts (C – O – C') is convex and compact. It also assumes Pareto optimality of contract and therefore, locates all contracts along the curve C- C'. The Nash model represents an infinite number of outcomes where payoffs are measured by cardinal utilities U and N for two players.
- c)



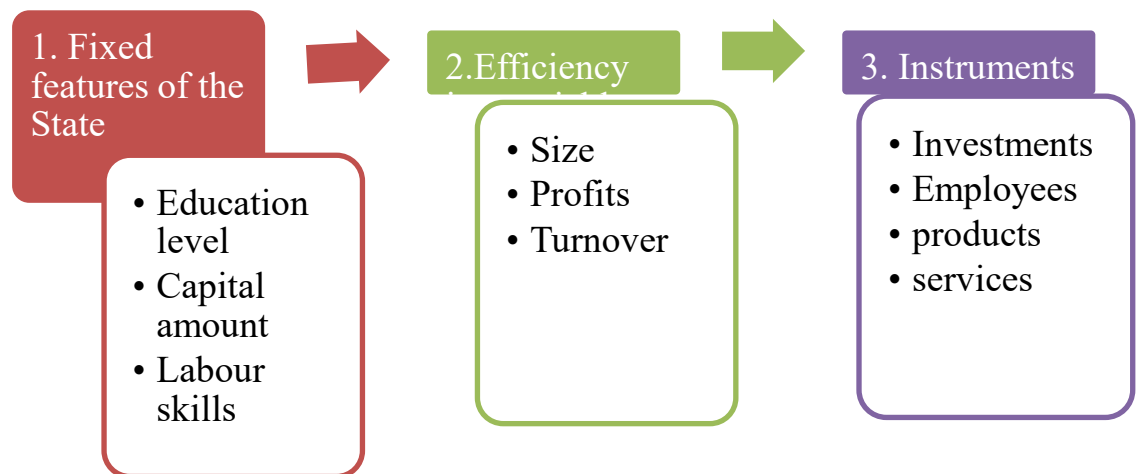
C'

d) The preceding graph shows that if conflict payoff is zero, meaning that the offer is so fair and optimal that there is no need to bargain. This is because the offer maximises at  $U^x$  multiplied with  $N^x$ .

e) Position under conflict payoff:



1.4.5. Key question in the functioning of entrepreneurship is the relation between efficiency and the three factors:



1.4.5. Efficiency varies as per goals of the firm. Instruments can be readjusted to the fixed status of elements, to improve efficiency. Given a goal for efficiency, the normative method can suggest **how the inputs can be combined and used** to give the output of efficiency goal.

1.4.6. In Managerial Capacity and Entrepreneurship, efficiency means the allocation of resources and ability in a way to maximise the output. The ratio of actual output to maximum output is Efficiency.

1.4.7. Measure of efficiency has the two aspects of **technical efficiency** and **economic efficiency (Price)** The technical efficiency is the choice of a correct production function most appropriate for the given firm.

1.4.5. The following can be made **variables for bringing improvements in efficiency**:

- a) Status of the entrepreneurial firm.
- b) Profits

- c) Turnover
- d) Assets
- e) Number of employees
- f) Power
- g) Quality of work
- h) Surplus value
- i) Good customer relations
- j) Minimizing costs.

1.4.6. Choice of efficiency variable is based on the **three factors of economic efficiency**, effectiveness and stating the objective correctly. Economic efficiency is **doing the things right**, and **doing the right things**. This gets reflected in the ratio of Input to Output + Effectiveness. Effectiveness implies the **ability to choose** the appropriate goals and objectives. For example, to reduce production costs is Input objective and to increase profit is Output objective.

1.4.7. **Four Measures of efficiency:**

1. When both input and output are specified and fixed, efficiency will be a measure of probability of success where outcome is classified as successful or unsuccessful.
2. Outputs are specified and inputs are variables.
3. Outputs are variable and inputs are specified.
4. When both output and input are variables, the measure will be the difference or ratio between outputs and inputs. The course of action that yields the greatest difference will be the most efficient.

Thus, efficiency measure involves economic profit as a measure of difference in value of Input and Output.

1.4.8. **Entrepreneurial Objectives:**



- a) For success it is important that the entrepreneur concentrates on the business, instead of trying several enterprises simultaneously.
- b) Profit is the most relevant goal variable and objective.
- c) Measurability of profits: Market prices as an evaluation of output and input, is a clear and meaningful concept to an entrepreneur.
- d) It is also a practical and useful goal variable for economic research on equities on the stock market.
- e) Profits measured as ratio of Input and Output, are to be additionally measured as 'the increase in aggregate consumption. (Aggregate consumption benefits): (Aggregate consumption costs). These should also be measured in terms of shadow prices.
- f) Factors that directly influence the profits of a firm should be researched upon regularly. Their trends in the market should be observed to increase the product prices and keep the firm profitable.
- g) This can be done by a simple method of analysis where clusters of firms are compared for differences and similarities within and between them.

#### 1.4.9. Defining the concept of 'Profit' for the firm is important.

##### 1. Profit in Economic Theory:

- a) Hicks' concept of one week's profit is 'the maximum amount of wealth that a person can consume during the week without being worse-off at the end of the week than he was at the beginning. (Hicks 1939: 176)

This definition refers to two earlier concepts of Adam Smith and Fisher. Adam Smith (1880s) defined profit as the amount

that could be consumed without diminishing the capital. Fisher (1906) defined capital as a 'stock of wealth at an instant time.'

- b) According to the theory of general equilibrium, 'profit' is 'accidental' and exists only during the period of adjustment or friction caused by the market forces.
- c) The monopoly- monopsony theory also regards profit as a consequence of imperfections in the market caused by product differentiation.
- d) Schumpeter (1934) viewed profit as an effect of disturbances continually created by entrepreneurs. They innovate to out beat their competitors, and earn profit as reward. But this reward is short lived because competitors copy and catch up with the innovation soon enough.
- e) An innovation could be an improvement in technology of production, the creation of new sales techniques, or a new managerial style. Consequently, innovators will always make profits. There lies the significance of research and development for innovation.

2. **Profit in modern practice:** for business and entrepreneurship the theoretical concepts of profit given above, are not sufficient or complete. **Profit and Wealth concepts** now include material assets, sense of financial security. Social status and other factors of the economic environment

- a) The economic concept of wealth defines profit as the surplus obtained after deducting the costs for factors of production from income received.
- b) Income measures the value of products and services and is normally expressed in monetary terms. In a market economy, the rate of 'turnover' is an acceptable measure of income.

c) Costs are expenses on activities relating to usage of material, aids, works, services that can be pre-calculated as a value.

d) Accounting profit: measures firm's position or Balance Sheet, its efforts as costs, and accomplishments as revenue, and its success as profit and loss statement. Accounting profit is calculated on basis of several accounting principles and legal requirements for ensuring objectivity in recording of profits per annum.

3. **Current Operating Profit (COP)** (a consistent use of current values.)

Plus	Sales
Minus	Current cost of material used
Minus	Current cost of wages and misc. expenditure
Minus	Depreciation on current value of assets
Minus	Current interest on borrowed capital
=	Current Operating Profit

4. **An Operational definition of Profit:**

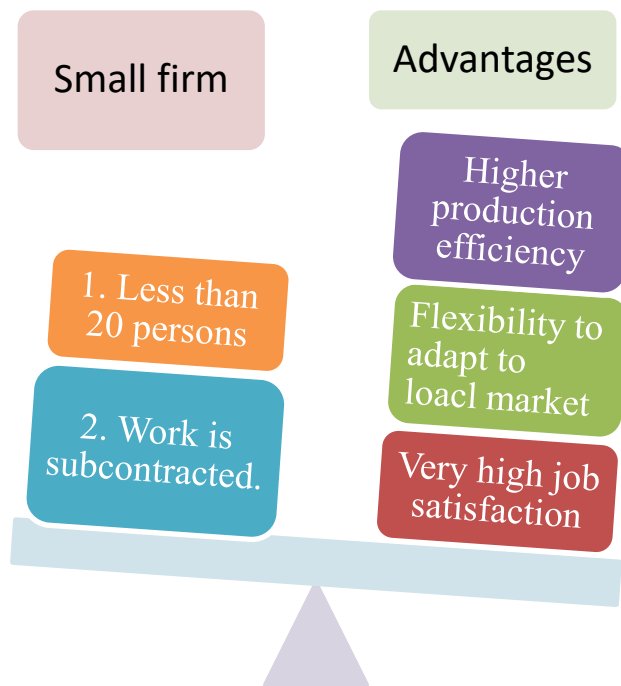
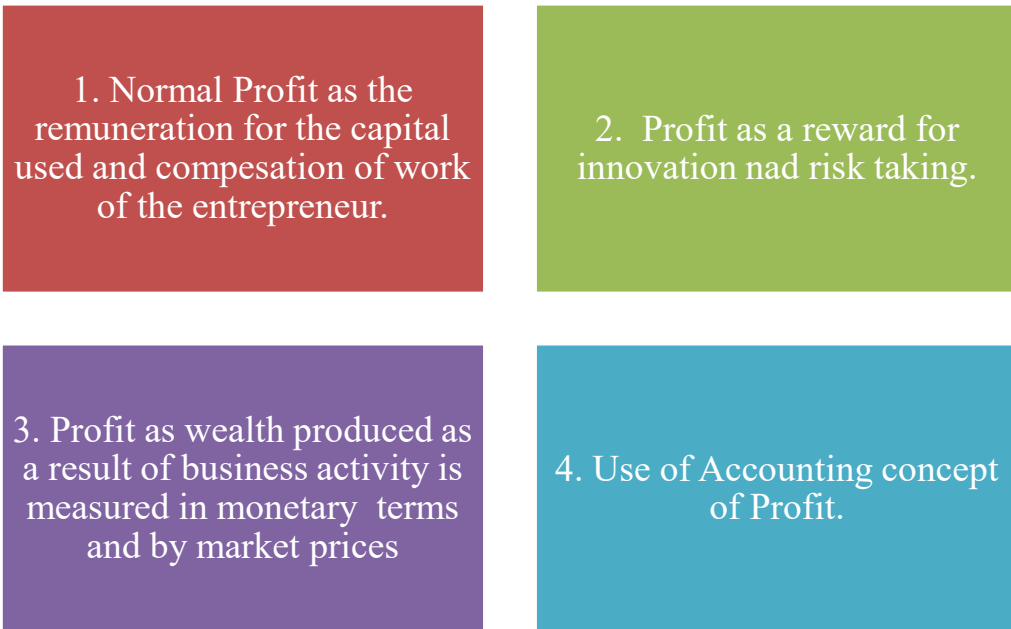
Sales (of Goods / Services / in Normal or bad week includes the weighted average week of activities evaluated in terms of current values.)

+ Charges received  
= Total income.

Minus current cost of material, services, wages,  
depreciation, interest foregone on capital used for business.

= Total Cost.

1.4.10. Profits for small firm / entrepreneur will include:



1.4.11. How does a firm set the price of products and services?

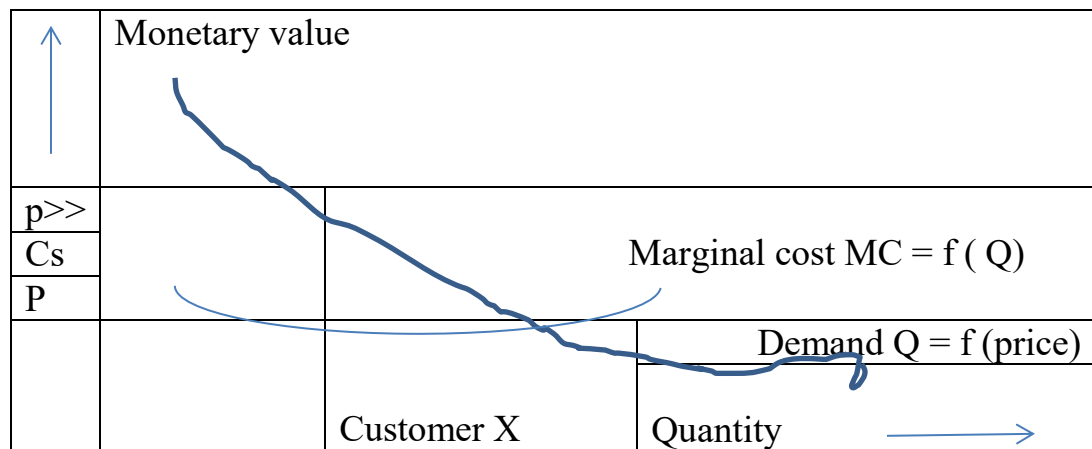
An entrepreneur can set the price:

- a) Optimal price after calculation of costs + profit margin.
- b) After bargaining.
- c) On basis of competition and quality, subject to market price.
- d) In a monopoly.

a) **Optimal pricing of a product.** Normally pricing involves consideration of how to get the maximum profit expressed as **(Price) x (quantity) – (unit cost) x (quantity)**

This formula is subject to a demand function, where (quantity) is a function of (price) and a cost function where (unit cost) is a function of quantity. Optimal price in a homogeneous market will be where price equals marginal cost.

Optimal pricing graph



b) **Bargaining** is an act of persuasion, which uses threats and inducements in a situation where the underlying power relation is based upon the degree of dependence upon one another.

**Bargaining Power:** is the ability of one Party A, to induce a cognitive and motivational structure of Party B, such that B becomes dependent upon A in order to achieve an aspired goal. Bargaining power further more acts as to make this cognitive and motivational structure of B, gain control over B's behaviour at a particular point of time.

Bargaining power **in Mathematical terms:**

$$(\text{Bargaining Power}) = f(I_b, I_s)$$

Where  $I_i = g_i(I_{im}, I_{io}, I_{ip})$ , for  $i = b, s$

$I_b$  = buyer's information.

$I_s$  = Seller's information.

$I_{im}$  = market information of actor i.

$I_{io}$  = information of actor i about opponent.

$I_{ip}$  = product information of actor i

- 3 **Pricing through bargaining positively** affects Bargaining Power.
- 4 Pricing based upon a calculation of cost reduces the Bargaining Power.
- 5 Bargaining power is positively influenced by an entrepreneur's expertise, which is reflected by length of training and branch of activity.
- 6 Bargaining power is positively correlated with the kind of research and innovation done by the firm.

1.4.12. **The buyer – seller relationship:**

## 1. Referent power

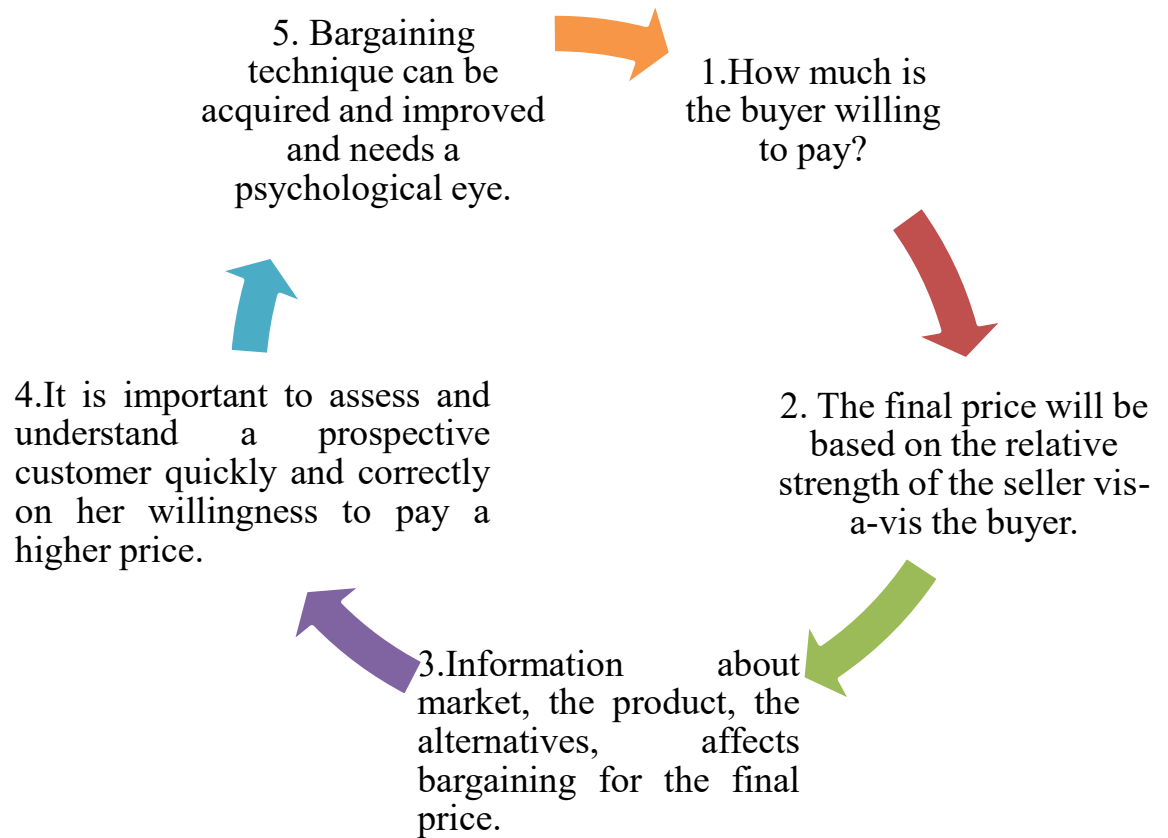
- A salesperson similar to customer is more likely to succeed than a dissimilar sales person.
- Identification power depends on similarity of beliefs and attitudes between the two.

## 2. Expert power

- Depends upon the degree to which the seller is regarded as an expert by the buyer.
- Appearance of the seller and the firm is important in generating a positive perception and buyer's willingness to pay more.

In sum, Bargaining based pricing involves four out of ten attributes namely, Services offered and Price (bargaining) and Store clientele and Post service facilities (Market Sedimentation). Indirect attributes are Exposure value of location, nature and quality, physical attributes of the store and advertisement. Lindquist attributes are Sales personnel and Store atmosphere.

### 1.4.14. Information on Customer:



1.4.14. A Primary Model of Bargaining Power.





1.4.15. A Model of Bargaining Power



1.4.14. Bargaining Power sub model

Length of Experience In the market	Network of contacts	Market formation +		
Price Policy	Bargaining Technique	Customer Information + =	Bargaining Power =	Gross Margin
	IMINNO	Product Information +		

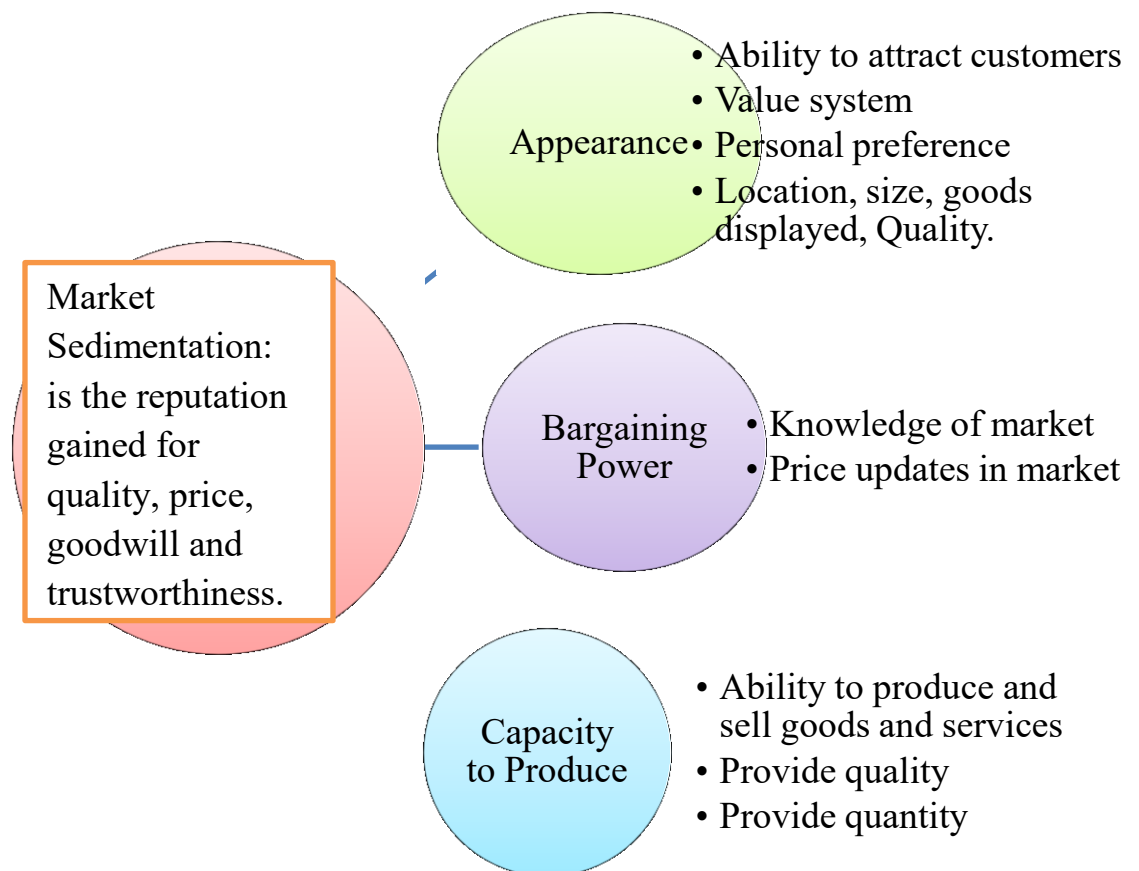
In sum, the Bargaining Power of an entrepreneur depends upon the relative strength of information that the seller possesses vis-à-vis suppliers and customers. But, **bargaining with each customer is a weakness.** Minimum price plus profits **must be pre-determined.**

1.4.15. **Problems and Disadvantages** of a small firm include:

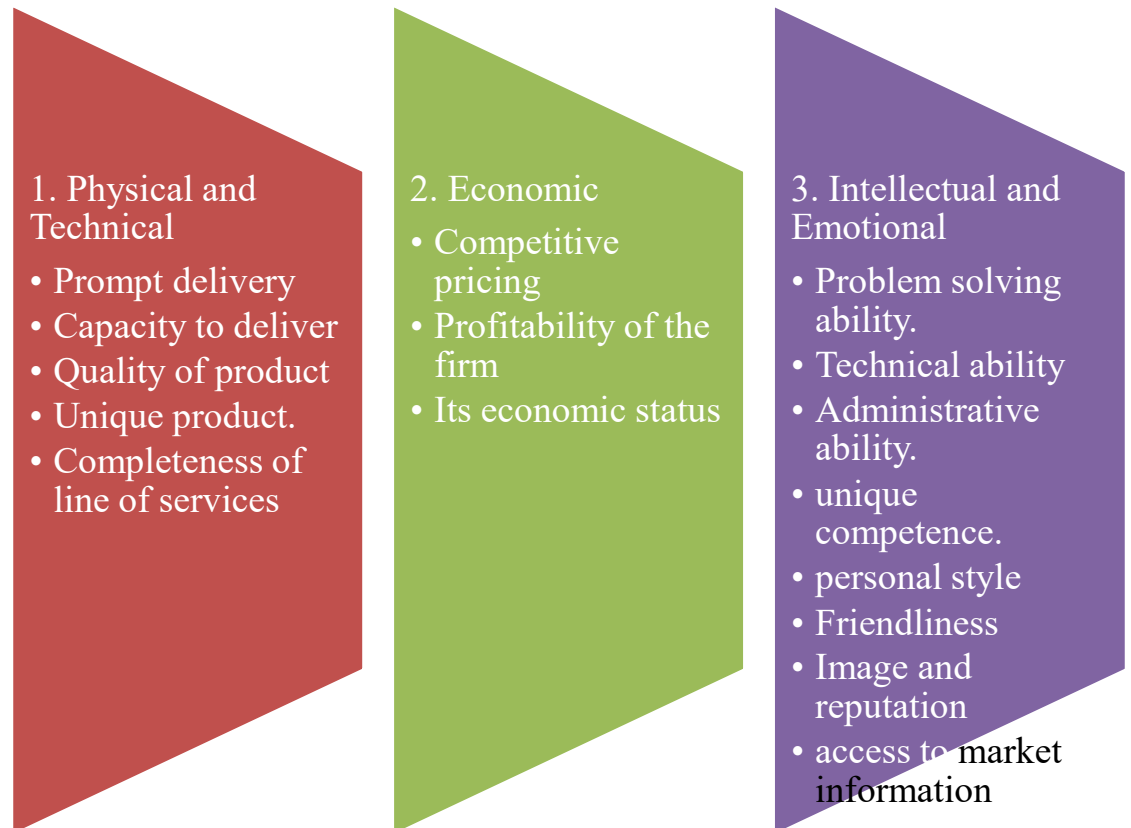
- a) Lack of capital
- b) Insufficient volume of sales
- c) Shortage of skilled manpower and raw material.
- d) Competition from formal sector.

1.4.16. Interdependencies of the three basic concepts in a small firm.

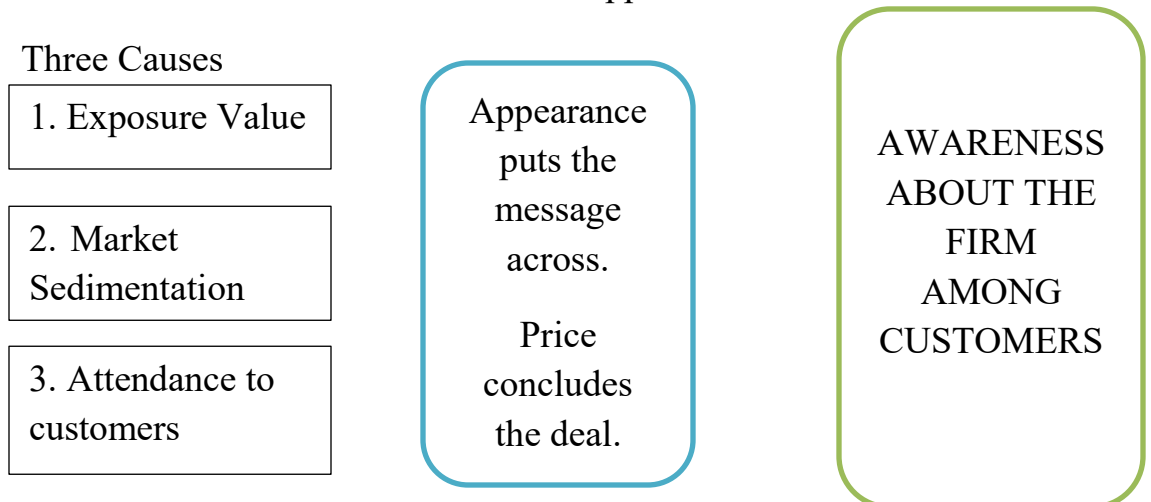
All the three are positively related to each other and to Profits.



1.4.17. Dimensions of firm goals that are affected in a Buying – Selling are



1.4.18. A model of cause and effects of Appearance.



1.4.19. Appearance sub model:

Cost of Rent	Location + Physical attributes =	Exposure Value +	Cognitive structure of customer	
Capital Cost of stock	Nature and quality of stock +			
	Store + =			
Salary cost of sales and promotion	Sales Personnel + Store atmosphere + Time spent on sales cost + Time spent on promotion =	+ Customer services + =	= Appearance + message of customer thereon + Price message	Turnover
Diversification + Patronage + Socio- economy	Clientele + Friends' opinion + Post transaction satisfaction +	Market sediment ation +	Bargaining power is provided by customer's messages on price and appearance.	

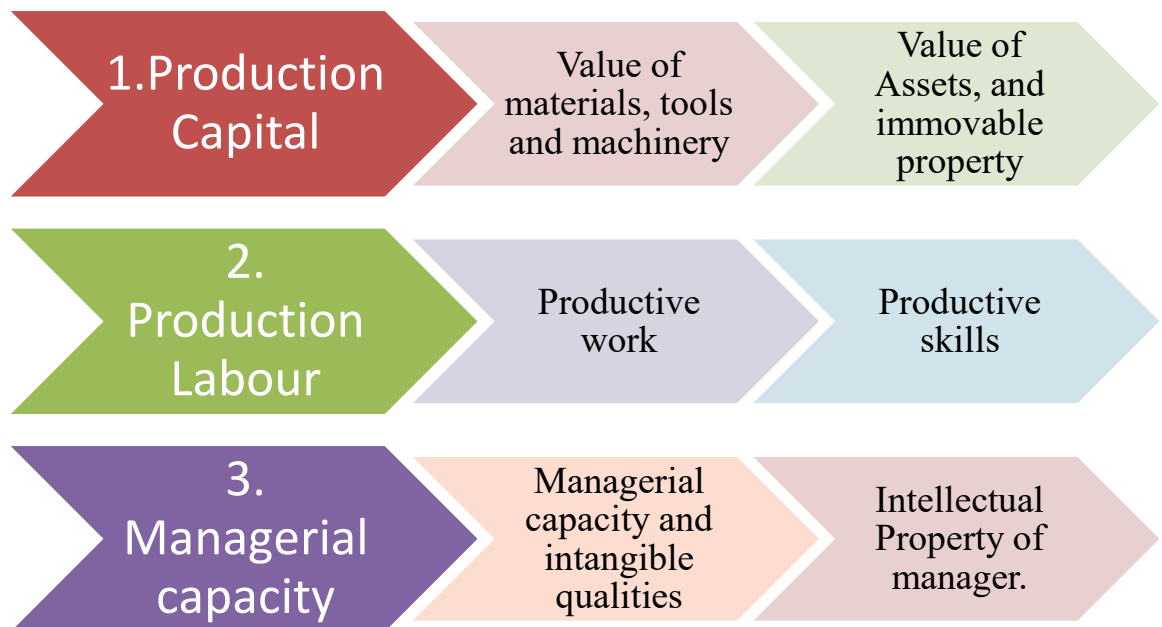
1.4.20. **Capacity to Produce** is a concept in economic analysis. It is 'the rate at which work is normally produced'. The Aim is to arrive at a model that expresses capacity as a function of the firm. This depends on multiple factors.

a) **Production** is the art of tapping a number of accumulated resources through organisation, and transformation, new assets

are created from resources. These resources in new form have a higher value, and they satisfy a need felt by customers.

- b) Economic definition in terms of competitive equilibrium and minimum average cost. Full capacity of a plant is output level associated with full competitive equilibrium.
- c) Definition is **related to cost of production**. Therefore, capacity to produce is the ‘output where the average cost curve has a minimal influx.’ It is ‘ the output produced during a normal year using the normal productive resources of the firm’
- d) In sum, Appearance attracts customers. Bargaining power settles a favourable deal. Capacity to produce involves inputs and outputs in the function to produce or convert input and output.

1.4.21. **A model of Capacity to Produce** has three sub concepts:



1.4.22. **Production Capital:** Model of Capacity to Produce of firm  $i$  ( $Q_i$ ) as a function of production is Capital ( $k_i$ ) Production Labour ( $L_i$ ) and Managerial Capacity ( $M_i$ ) can be stated as :

$$Q_i = A K_i^x L_i^B M_i$$

where  $A$  is the constant and  $x$  and  $B$  describe the average firm, while  $k_i$ ,  $L_i$ ,  $M_i$ , describe the specific firm  $i$ .  $M_i$  is a randomly distributed residual term with one as mean and variance as finite.

- a) Capacity to produce is positively influenced by the number of workers, apprentices, skilled workers, capital invested in tools and machinery.
- b) There are strong correlations and interdependencies between the number of apprentices, number of skilled workers, capital invested in tools and capital invested in machinery.
- c) Output ( $Q/K$ ) is measured by value added per unit of capital cost and workers ( $W/K$ ). The marginal productivity of production labour is diminishing.
- d) The rate of technical substitution is constant. Technical substitution means that machinery is substituted for tools and vice versa. There is a constant elasticity of substitution of machinery for tools.

1.4.23. **The Production function** is central to the Economic Theory of the firm as it **measures the Relation between Input and Output**. The five main assumptions in the function

- a) Outputs and inputs are known and specific.
- b) Outputs and input markets are given.
- c) Marginal Revenue and Marginal Cost curves of the firm are continuous. Marginal Cost is convex ( $f'' > 0$ ).
- d) Marginal Revenue curve of any firm intersects its Marginal Cost curve from above.
- e) All firms attempt to maximize profits.

1.4.24. According to Ansoff, the last assumption is most damaging to the Theory of Corporate planning as no mechanism exists to describe or explain a search for outputs and inputs beyond the ones originally considered.

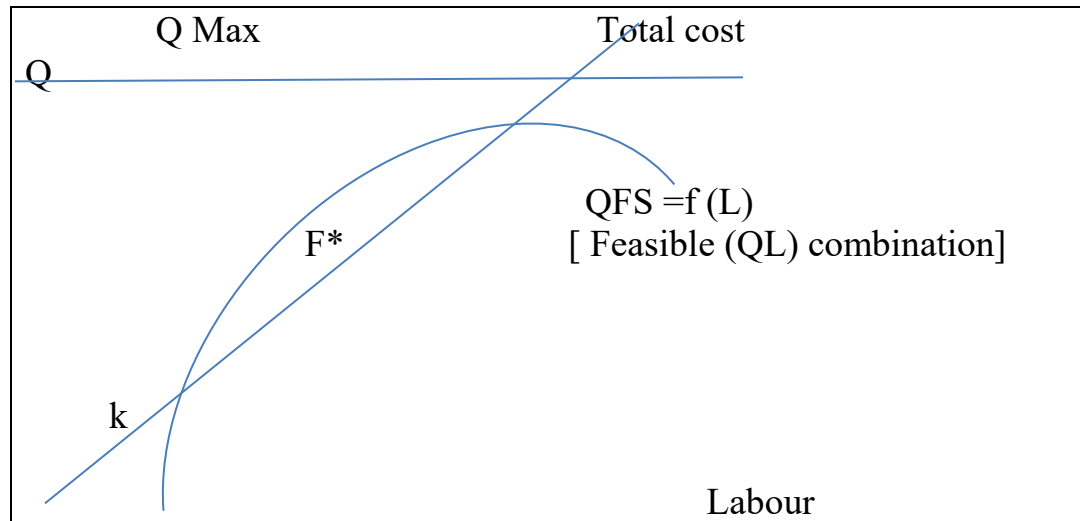
1.4.25. Capacity to Produce sub model

1.Salaries paid	to Skilled workers +	Production Labour costs		
	to Apprentices =	+		
Capital cost	Machinery + Tools =	Production Capital costs	= Capacity to Produce	= Value Added
		+		
Length of skill development period	Education + Skill development + Achievements + Family support =	Managerial Capacity cost		
		+		

1.4.26. Managers attempt to maximise the value of a utility function, subject to three constraints :

- a) A minimum required profit constraint.
- b) A non- negative management slack constrain.
- c) A non- negative expenditure on staff constrain.

1.4.27. Beaumol’s model assumes that a firm attempts to maximise total revenue subject to a minimum profit constraint.



Output  $Q$  = is a function of Capital ( $k$ ) and Labour ( $L$ ).  
 Cobb-Douglas function is  $Q = A k^x L^{\beta}$   
 Diminishing returns described by Marginal Productivity (MP) of either of the input factors .  
 eg.  $MP_L = \Delta \text{Output } Q / \Delta \text{labour } L = \beta A K^x L^{\beta-1}$

1.4.28. **Elasticity of Substitution**: Rate of technical substitution is the rate at which  $L$  must be substituted for  $K$  in order to maintain the level of output.

$$-\frac{\Delta F(K, L)}{\Delta k} + \frac{\Delta F(K, L)}{\Delta L} = 0$$

where it is assumed that  $f(k, L)$  is a continuous function. As  $K / L$  declines when labour is substituted, the Rate of Technical Substitution will decline as the production becomes more and more labour intensive. As such, RTS changes with labour intensity of the firm.

1.4.29. **Constant Elasticity of Substitution (CES)** is maintained even in production functions in which capital labour substitution is elaborated



to suggest that elasticity of substitution is different from unity. Such production functions have two major characteristics.

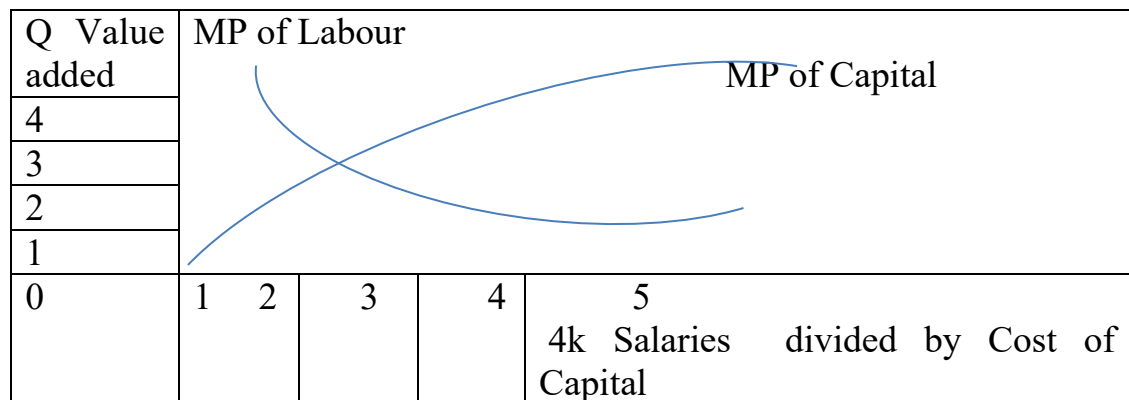
- a) First, that they are linear homogenous of the first degree.
- b) Second, they have a constant elasticity of substitution.
- c) Cobb-Douglas production function is linearly homogenous if  $\alpha + \beta = 1$  and has a CES equal to unity. Thus, this is a member of CES class of Production Functions.
- d) Law of diminishing marginal productivity:

$$Q = A K^\alpha L^\beta \text{ and } MP_L = \frac{\Delta Q}{\Delta L} = \beta A K^\alpha L^{\beta-1}$$

Thus, a condition for diminishing MP of Labour is that  $\beta$  is less than unity and that of Capital is less than unity.  $MP_k = \frac{\Delta Q}{\Delta k} = \alpha A L^\beta K^{\alpha-1}$ .

1.4.30. **Production Labour : Marginal productivity (MP) of labour and capital:**

$MPL = MP_k$  when  $LC / CC = 2.2$ . There is a constant elasticity of substitution of production salary cost for cost of production capital. This hypothesis has been substantiated and holds true to all models of Cobb – Douglas type where the exponents add up to unity.



1.4.31. **Cost of Capacity to Produce:** Output is measured by annual value added. Labour is measured by annual salaries. The interdependency between Output per capital unit and labour intensity is supported by a

correlation measure of +0.55 (1% level of significance). Output per labour unit is positively influenced by the capital intensity, but the marginal productivity of production capital decreases continuously. This marginal productivity of capital nears 0 as ratio goes above 10%.

- a) With a **log linear model base**, the log is + 0.84 (1%) which is higher than the measure in a linear model base of +0.55% (1%). Value of the exponent is rather small as mp nears 0.
- b) A comparison of the two regression models similarly indicates a higher  $r^2$  for a log linear model. Therefore, hypothesis is to be accepted. Legend: Table 8.20. Output = Q. Cost of capital = k. Salary cost = L.
- c) A comparison of the **two Regression models**

Regression 1	Regression 2
$Q/K = 35.7 + 0.45 L/K$	$Q / k = e^{1.6} + (L / K)^{0.96}$
Level of significance = 1%	Level of significance = 1%
$r^2 = 0.306$	$r^2 = 0.708.$

- d) Advantages of scale would imply that capital is more productive when employed on a large scale. However, the output per capital unit does not increase if total cost of capital increases. Therefore, there are no advantages of scale if more capital is invested in tools and machinery.
- e) Output in Production capital is positively correlated with cost of capital invested in tools and machinery. Output Q is measured by annual value added and cost of capital. K is measured by depreciation and interest foregone on tools and machinery. A correlation coefficient 0.50. Hypothesis cannot be rejected on 1% significance.
- f) Output per labour unit is positively influenced by the capital intensity, but the marginal productivity of production capital

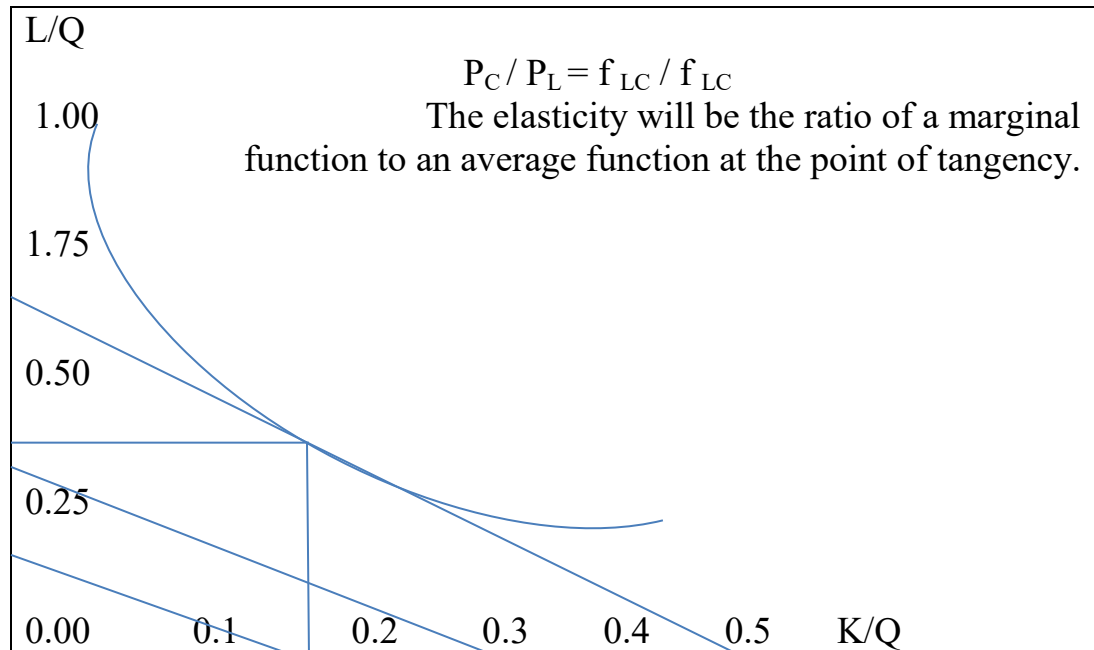
decreases continuously. This marginal productivity of capital invested in labour nears 0, as ratio goes above 10%.

1.4.32. **Production Managerial Capacity:** Out of four factors of a firm, three, are positively inter-related. These are age of firm, age of entrepreneur, managerial capacity. The fourth, namely, the length of education of manager is negatively correlated only to the age of the entrepreneur. This is because education and learning are lifelong processes. An educated manager prefers a modern methodology. She/he also undertakes to develop the skills of his employees and apprentices. The length of education correlates with capital intensity of the firm (+ 0.18), with value of machinery (+ 0.22) with value of tools (+0.19). It correlates positively with time spent in teaching apprentices (+0.24).

1.4.33. **Cost Minimisation:** Average production function indicated in the graph below, shows the isocost lines simply have a slope of -1. The isocost line indicates the ratio of price to input factors. This is because the cost of labour and cost of capital have been expressed in equal monetary terms. The graph shows how an optimal input combination depends on the isocost line. Input factors are substitutable for one another, but this elasticity depends on prices, and is defined by a measure of elasticity of substitution. (o')

$$O' = \frac{\text{Relative change in LC / CC}}{\text{Relative change in } P_C / P_L} = \frac{\Delta (LC / CC) / LC / CC}{\Delta (P_C / P_L) / P_C / P_L}$$

Value of O' will be 0 if the two inputs are used in a fixed proportion and no substitution can take place. Alternatively, where substitutes are perfect, a small change in prices will cause radical changes in input ratio



a) Derived from the graph is that the relation  $LC / CC = 2.2$  based on price ratio  $PC/PL = 1/1$ . Annual labour cost as well as annual capital cost was measured in equal monetary flow terms.

b) This relation can also be stated as  $LC / CC = 2.2 P_C/P_L$

$$\text{Thus, the marginal} = \frac{\text{delta} (LC / CC)}{\text{Delta} (P_C / P_L)} = 2.2$$

$$\text{And the average} = \frac{LC / CC}{P_C / P_L} = 2.2$$

c) Consequently, the elasticity of substitution will be  $2.2 / 2.2 = 1$ .  
 This means that there exists a constant unitary elasticity of substitution in cost minimisation.

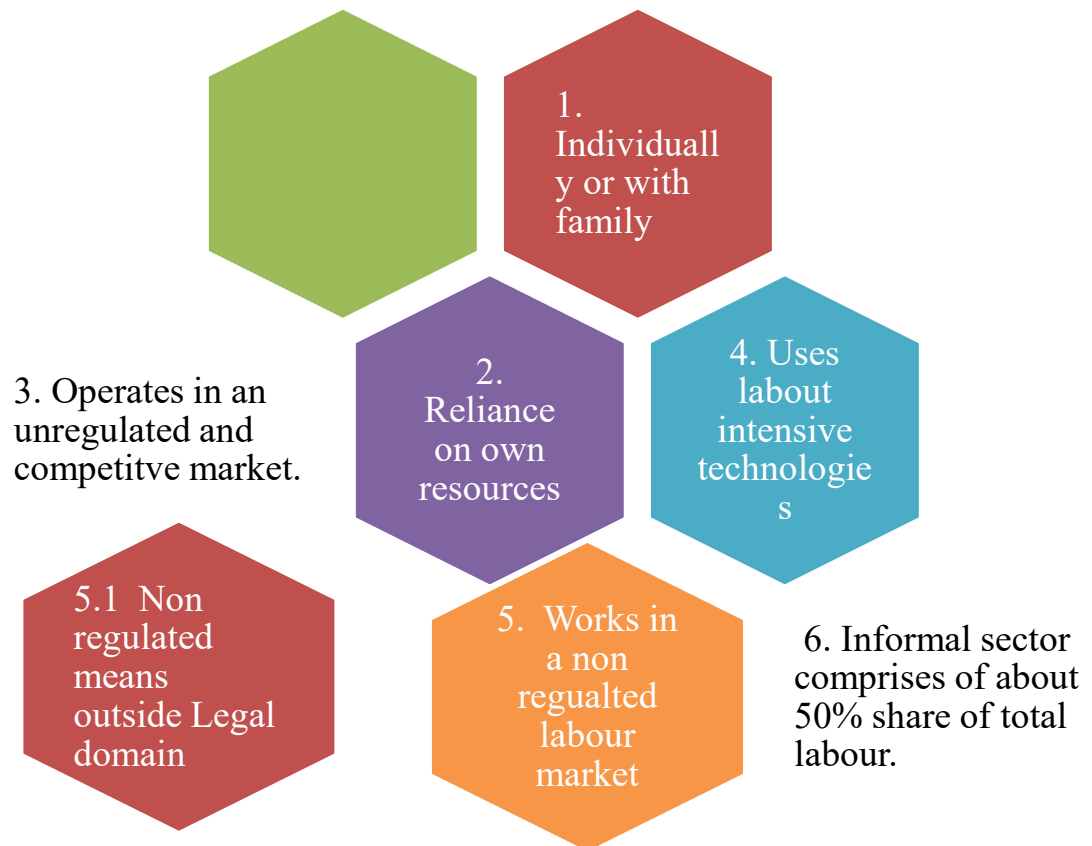
1.4.34. A challenge to the Economic Theory of the firm is made by the Behavioural Theory of the firm that is more concerned on Decision Making. Its focus is on satisficing behaviour instead of maximizing behaviour. Assumptions in Behaviour Theory are :

- a) Bounded Rationality.
- b) Multiplicity of goals.
- c) Sequential attention to goals
- d) Standard operation procedure
- e) Organisational slack to stabilize coalitions.

1.4.35. **Conclusions:**

- a) Capital invested in Appearance has a stronger effect upon profit than capital invested in tools and machinery
- b) Appearance relies to a much larger extent upon capital than upon entrepreneurial time spent on sales and promotion activities.
- c) Capacity to produce benefits more from production labour than from capital invested in tools and machinery.
- d) Education seems to be a key variable which affects most manifest variables and the length of education has important indirect effects in the model because effects of education are indirect.
- e) Interdependencies among the principal variables, has a strong positive correlation between appearance and capacity to Produce.
- f) A negative correlation exists between Appearance and Bargaining Power.
- g) To determine factors that should be included in the model case studies are helpful.
- h) Synthesis of a precise definition and operationalization of concepts, construction of a model, generation of hypotheses.

1.4.36. Advantages of informal small sector entrepreneur:



1.4.37. Theoretical classification of small firms

Classification		Number of employees
1. Small firms	1.1 Small 1 small	01 to 09
	1.2 Small 2 small	10 to 19
	1.3 Medium 1 small	20 to 49
	1.4 Medium 2 small	50 to 99
	1.5 Large small	100 to 200
2. Medium sized firms	2.1 Small Medium	200 to 499
	2.2 Medium-Medium	500 to 999
	2.3 Large Medium	1000 to 1999
3. Large firms		More than 2000

- a. Small entrepreneurship is characterised by deep seated individualism. Therefore, it is advisable for it to concentrate on one or two activities at a time. Today in India, Small firm is defined under MSME Act and Rules.

1.4.38. **Advantages of Small scale entrepreneurs:**

1. Superior knowledge of local market. Actively look for new contacts for getting workorders.

2. Ratio of equity to total asset is average, but profits are higher. Savings are relied upon.

3. High growth potential.

4. High job satisfaction and specialisation.

5. Superior Quality of work

6. Greater possibilities for innovation and initiatives.

7. Flexibility in production and adaption to customer specific demands

8. a democratic working atmosphere, greater equality among workers.

- 1.4.39. **Collection of Data for analysis:** Population and strata for sample are to be defined and sampling procedure is to be described. Key variables in operations to be explained and defined.

1.4.40. **Organisation of the Analysis Report:**

a) **Background.**

1. Introduction that should include the Research or analysis question(s).
2. Methodology: explanation of methods and sample collection.
3. Prior Researches on Profit, Small firms, Informal sector.

b) **Study:**

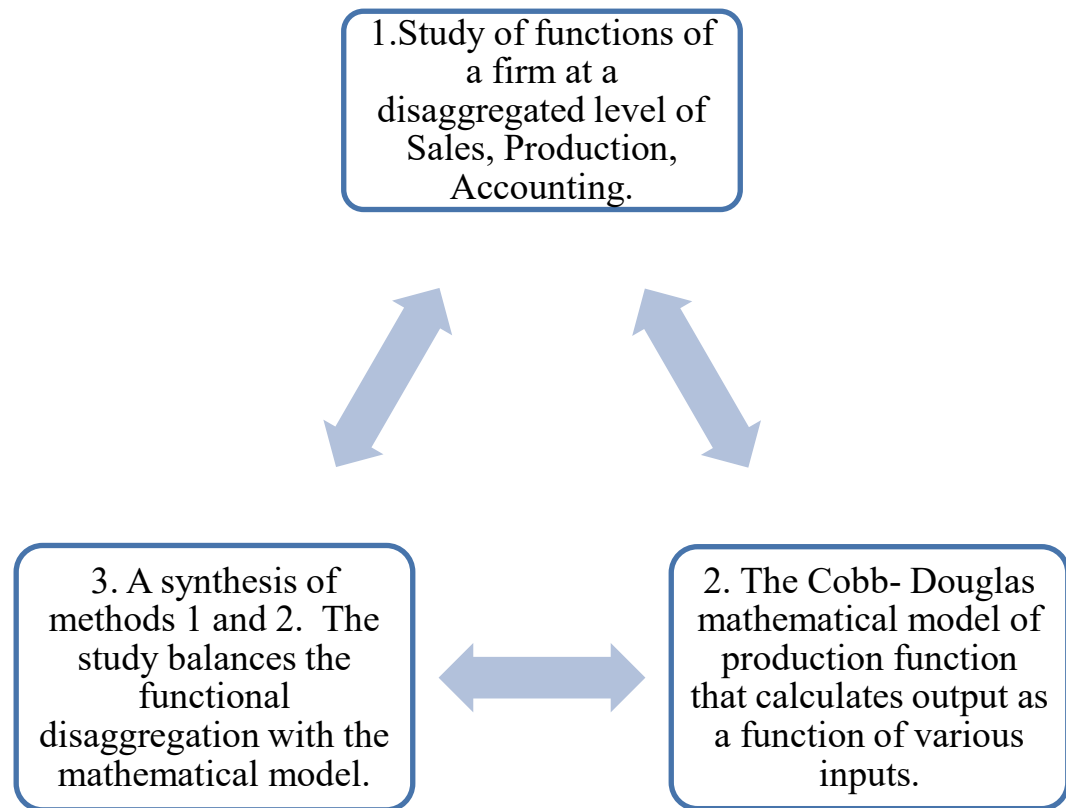
4. Case studies of successful firms, unsuccessful firms, and outline of the model.
5. Appearance: theory, case study, and a synthesis along with a sub-model.
6. Bargaining Power: theory, case study impressions and a synthesis with a sub- model
7. Capacity to Produce: theory, case study impressions and synthesis with a sub-model.
8. Testing of Hypotheses on Appearance, on Bargaining Power and on capacity to produce
9. Testing of the Model An introduction to LISREL, A linear model, and a Log linear model
10. Results: Conclusions, that is to include a review of the mode, a dynamic speculation and suggested research areas for future.
11. Normative Implications: Development Objectives, General Instruments, Selective Instruments
12. Summary of the background, the study, the results.

1.4.41.        **METHODOLOGY FOR ANALYSING SMALL FIRMS**

- a) Functional Business Analysis
- b) Constant Comparative Analysis
- c) Multivariate Analysis
- d) Latent Variables Analysis.

1.4.42.        **Functional Business Analysis** can be of three kinds





1 **Functional Areas Analysis (FAA):** Thinking in functional terms is basic to managerial reasoning. Functional Area Analysis is a synthesis that attempts to find out how well the activities in an entrepreneurship are being performed? How good is the work environment and how well do the employees interact.

2 Studies how resources are utilised in the different functions of the firm. Accounting systems focus on end products, but overhead costs are incurred and registered in functional areas. One function is converted into an accounting unit and sub divided into multiple sub-functions. This is developed into a sub model.

3 Production function is a general concept that includes continuous and discontinuous factors. As per economic theory, a firm is a technical unit because input factors are combined to produce the

output. One output  $Q$  and multiple inputs ( $x, y, z, \dots$ ).  $Q = f(x, y, z, \dots)$

4 **Cobb-Douglas production function** is a special case of a Production function as it includes Labour ( $L$ ) Capital ( $K$ ) and one catch all variable termed ( $A$ ). This variable describes all factors such as technology, managerial ability, raw material etc. to create

$Q = A K^\alpha L^\beta W^\gamma$ .  $W$  = Interfirm difference and residual factors. It has Mean = 1 and a finite variance.

5 **'Functioning Efficiency' Analysis and Method:** In this focus is shifted from the production management perspective, where resources are transformed into output, to an inner view on how functions are organised and why are there differences in efficiency.

For 'efficiency' analysis factors are subdivided as per function, as Labour with sub groups of production labour and salesmen; capital with sub groups of production capital and sales capital.  $Q = f(h_1, h_2, \dots, h_n)$  where  $h$  is the functional capacity.  $H_j = f(r_{1j}, r_{2j}, \dots, r_{mj})$  where  $r_{ij}$  denotes resource utilized for the function. This enhances explanatory value of the analysis.

1.4.43. **Constant Comparative Analysis:** is a strategic methodology for finding plausible hypotheses. The strategy depends on whether the aim is to develop a formal or a substantive theory. It includes determining the scope of the population for the sample and a procedure for generation of categories.

a) **Steps for generation of categories:** Theory of Growth of the Firm is a substantive theory that describes an empirical area of enquiry and is grounded in data. This **data is to be compiled.**

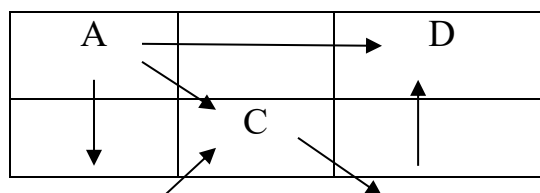
- b) As per Decision Theory, generation of categories involves **sub grouping** the sample according to research question.

The sub group should be exhaustive and mutually exclusive. The sample size should be large enough to provide the output required. Mode and true mean to standard deviation depends on sample size and questions posed.

T –test is an approximate method which makes it possible to calculate a required sample size with the standard deviation of the point estimate.

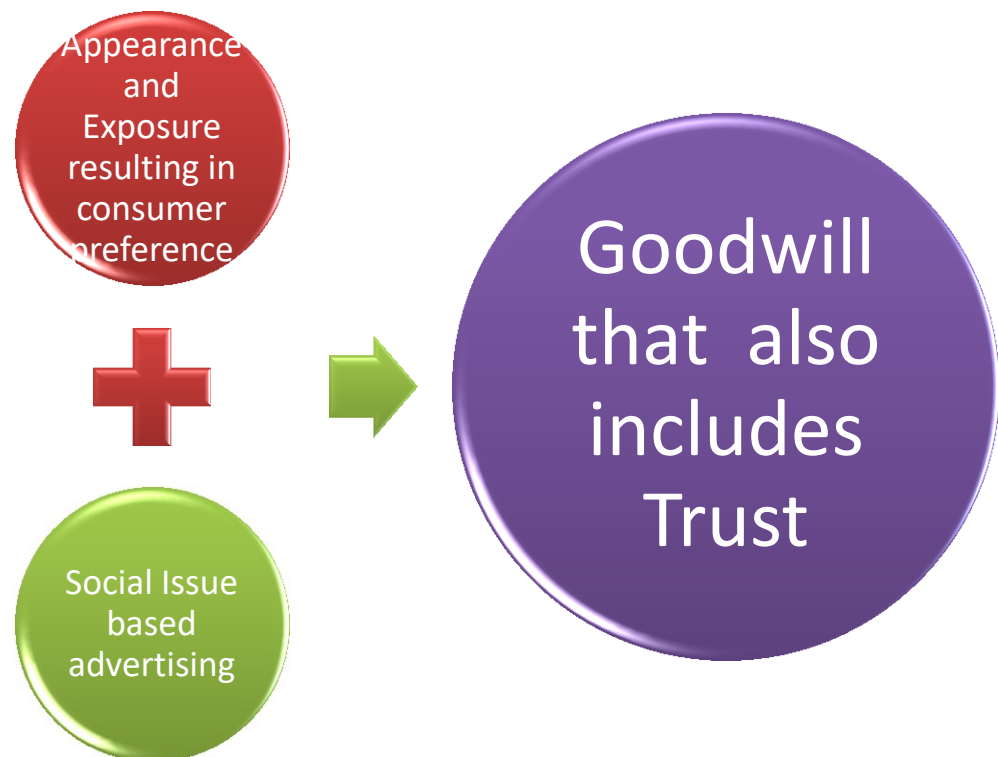
- c) **Finding an index as a benchmark.** This is an observable phenomenon which is substitutable and facilitates grouping of categories for data. For example the number of years of experience as a manager needed for next level responsibility.
- d) **Comparison of data** for similarities and dissimilarities to determine the conditions on which the categories will be generated.
- e) Finally, the properties that are to identify each category are to be created.

1.4.44. **Multivariate Analysis:** is based on variables involved and the co-relation between them. The Third variable factor is complementary or intervening. Interdependent variables are clearly understood through the following diagramme. Arrows indicate the interdependencies between five variables.





1.4.45. **Latent Variables Analysis:** Manifest variables such as capital invested, material purchased, output created are visible and quantifiable. Co-related to these manifest variables are Latent Variables that are invisible and concealed. Goodwill generated in the market by a firm is a Latent Variable. This goodwill has a notional value and depends on the following:



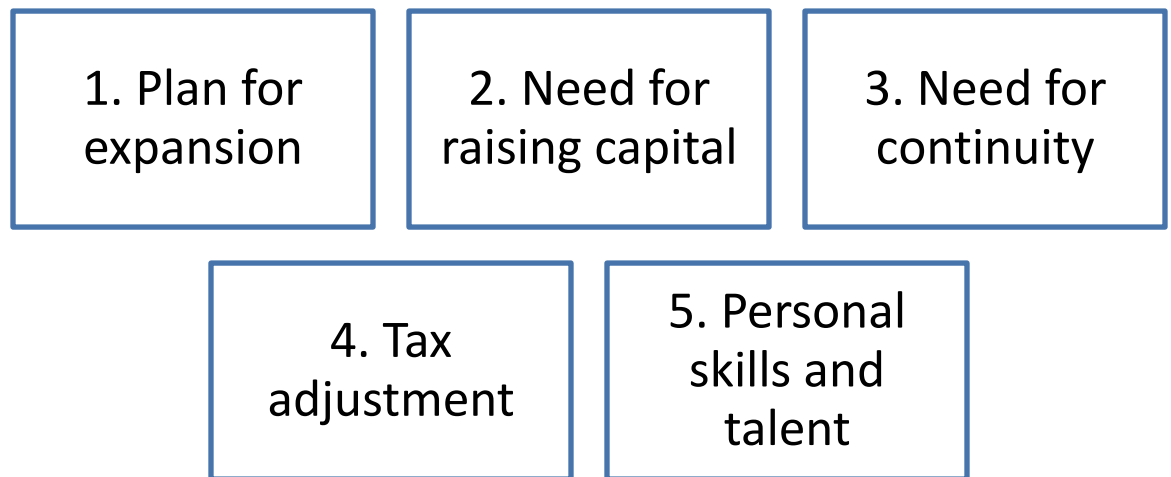
1.4.46. LISREL is a computer based programme which is able to analyze linear structural relations (Li S Rel.) It is a model of high generality. More specific statistical models can be derived from it. Its two components are the measurement model and the structural equation model.

- a) **The measurement model** specifies the relation of manifest variables to latent variables. This is factor analysis model where manifest variables are selected as per Causal Reasoning. The selected Manifest Variables are converted into a hypothetical model. Then LISREL is used for a test of the hypothetical model against empirical data.
- b) **The structural equation** model estimates the relation between latent variables as a second step of the analysis.

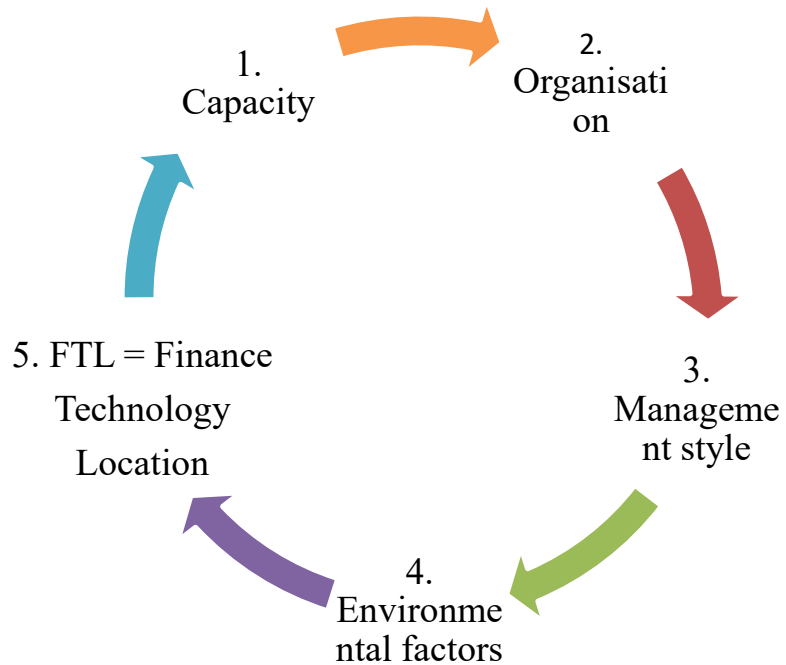
1.4.47. **Collection of data for analysis:** involves defining the key variables for the analysis. Definitions make verification and comparisons easier and enrich the analysis. Variables can be defined as per Constitutive definition or Operational definition. Constitutive definition is by using concepts in various theories. In Operational definition method a variable is assigned a meaning by specifying the necessary activities or operations required to measure the variable as follows:

- a) **Value of assets** is to be calculated as per book value, current value which is the Price that can be obtained if the asset is sold today.
- b) Normal profit is distinct from super normal profit during festive season and other occasions.
- c) Normal business in week or month as distinct from good or bad period.
- d) Costs of raw materials and overheads per week or month or season.
- e) Value of 'turnover'
- f) Cost of capital includes loss of interest and other opportunity costs of capital.

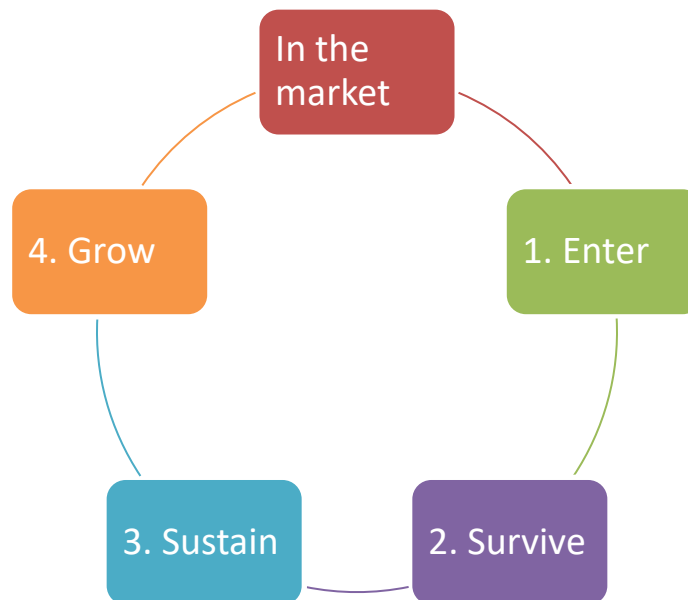
1.4.48. Factors for selecting a form for the firm in Manufacturing, Trade or Business and Services sectors.



1.4.49. Project or firm parameters: COME and FTL



1.4.50. Competitive edge:



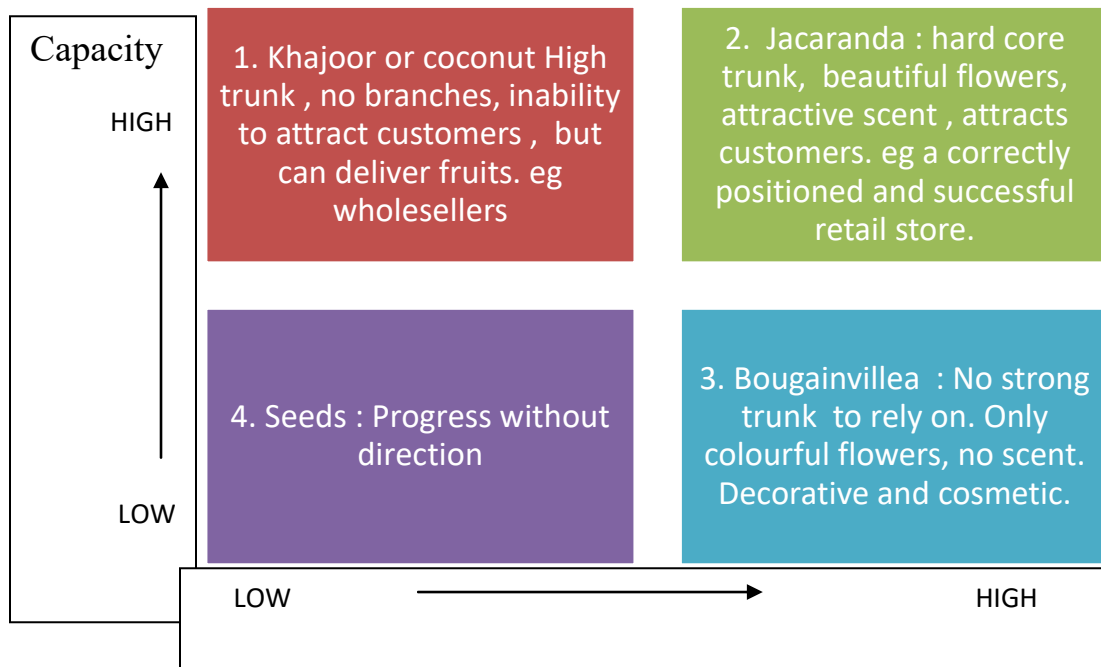
1.4.51. Institutional interface is part of **economic environment** of the industry. It comprises of Institutions, legal framework and official authorities for the sector. The decisions and changes in the economic environment have a direct influence on the business firm in the sector.

- a) **Skill** is an ability to demonstrate a system and sequence of behaviour that is functionally related to attaining a performance goal. Using a skill is not a single action but a series of actions. Each action contributes to progress in one direction towards the goal. It enables the capabilities of a person to function effectively in a given situation.
- b) **Motive** is a recurrent concern for a goal that drives, directs, and selects the behaviour of an individual.

i.



1.4.52. Structure and sustainability of a firm



This completes the entrepreneur unit. For other advance topics refer to pdf on Learning Material for Civil Services Main Examination Management Elective Papers 1 and 2

